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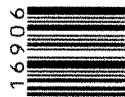
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CHINA BUSINESS

THE WALL STREET JOURNAL BRIEFING

Inside

China has tightened private investment in state business areas, the state has monopolized, a major infrastructure project competition while helping private (Chinese) companies compete not for with potential foreign firms.

In a recent press statement last week, the State Council said private companies are not permitted to invest in any sector of Chinese heavy industry.

Under the new policy, private companies may legally engage in all industries, set up banks of a certain scale, provide telecommunications services and operate airlines. Other sectors now open to three private entities, health and education, and defense.

The policy comes ahead of the annual meeting of China's legislative body, the National People's Congress, when promotion of the private sector is expected to be discussed. The private sector is the country's fastest-growing one, comprising one-third of the economy. But private businesses still face tough

Policy Extends Reach of Private Business

Private companies have already swelled into some of the industries targeted by the new policy. Private firms that already of Beijing are set to start work on this month, Internet manufacturer Huawei Technologies Co., supplies the military. But many private businesses operate in gray areas of the law, leaving them vulnerable.

Businesses involved in the drafting process say the policy gives legal protection to existing private ventures, and helps level the playing field for future ventures.

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New Competitor

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Regulations Issued on Foreign Franchises

China has issued regulations to regulate foreign franchises, the first time the country has done so. The regulations are aimed at protecting the interests of Chinese consumers and ensuring the quality of foreign franchises operating in China.

The regulations require foreign franchises to register with the State Administration for Market Regulation (SAMR) before operating in China.

The regulations also require foreign franchises to provide information to Chinese consumers about their products and services.

The regulations are expected to be implemented in the near future.

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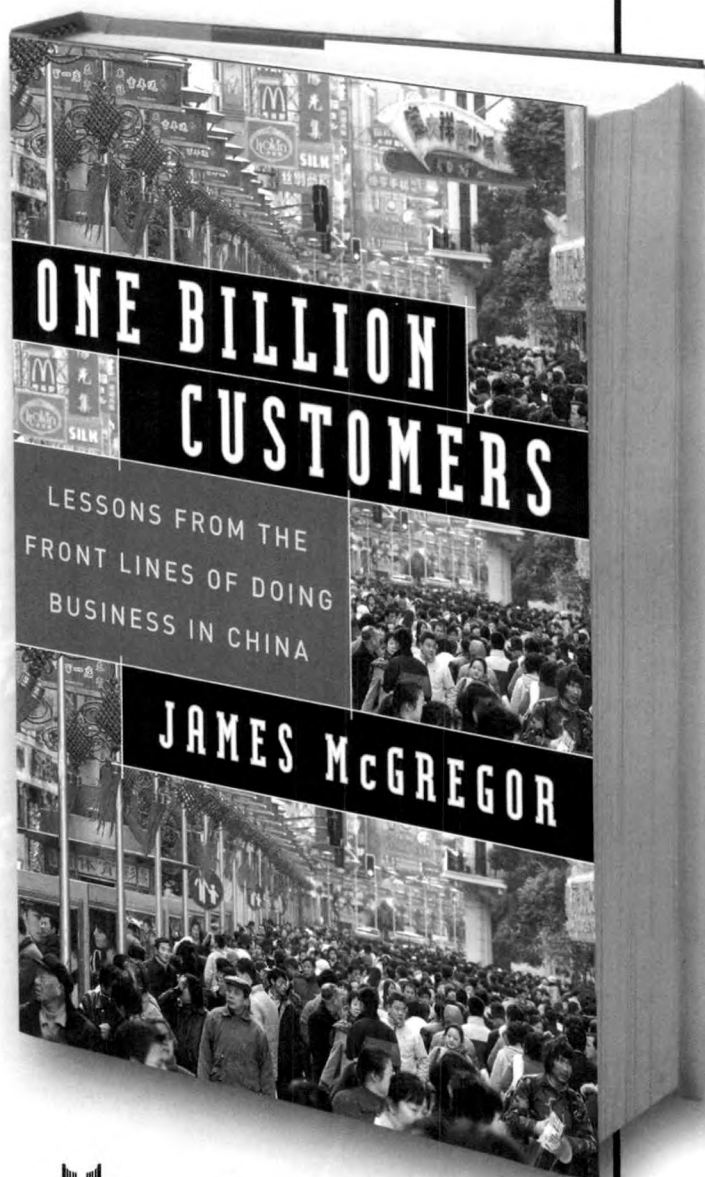
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IN CONFUCIAN THOUGHT, the dynasty fell when heaven withdrew its mandate, or *tianming*. The Greeks, on the other hand, attributed the end of a reign to *hamartia*, a tragic flaw within the ruler himself. In many dramas this was the sin of arrogance, *hubris*. Perhaps Asian politics are becoming more Greek, because looking around the region it seems like much of the present instability could easily have been avoided if politicians had approached their callings in public service with a modicum of humility.

Nowhere is that more apparent than in Taiwan. President Chen Shui-bian entered office six years ago on a wave of disgust with the Kuomintang's corruption and oppression of native Taiwanese. But immediately he created an "imperial presidency" that simply adopted the methods of the KMT, using the power of office to line his family's pockets and intimidating critics in the opposition and media. Even Mr. Chen's supporters like former President Lee Teng-hui are now calling for his resignation. As Jonathan Adams writes in this issue, the political turmoil is contributing to a crisis of confidence in Taiwan.

Similarly in Seoul, as Balbina Hwang reports, President Roh Moo Hyun adopted a domineering approach to politics, squandering the goodwill of the electorate so that the opposition Grand National Party won a landslide victory in nationwide elections in May. In Thailand, too, Thaksin Shinawatra badly miscalculated the degree to which overwhelming popularity among the rural poor gave him the right to ride roughshod over his critics. While there were always powerful interests lined up against him, as Pichit Likitkijssomboon's analysis shows, he ultimately handed his enemies the means with which to defeat him.

Pride went before a fall in East Timor, too, as President Mari Alkatiri tried to settle old scores by sacking a third of the army. Lin Neumann's essay describes how the young nation is now at the brink of collapse as a result. And as my colleague Colum Murphy writes, Malaysia's Mahathir Mohamad seems hell-bent on tearing UMNO apart yet again by undermining his successor, Prime Minister Abdullah Badawi, for showing insufficient respect for some of his ill-advised policies.

And finally to Singapore, which maintains a facade of stability by keeping a tight lid on disrespect for PAP authority. During my interview with opposition leader Chee Soon Juan, I was impressed by the bravery of a true public servant who suffers a stream of abuse and persecution from the Lee family government. But the more Lee Jr. insists that Mr. Chee is a liar, a cheat, a crook, the more distasteful his hubris becomes.

H.R.

LETTERS

Be Aware!

KUDOS TO GORDON CHANG! His article ("Halfway to China's Collapse," June 2006) has correctly pointed out that the Beijing regime can't salvage its survival by clinging to economic growth.

The Chinese Communist Party, however, has done one thing successfully: turned a communist regime into a Nazi-like regime. The Nazification of China requires no change of the one-party dictatorship, party-controlled troops, state-controlled society and censored media. In order to prolong its lifespan, a Nazified China can use expansionist nationalism to invade neighboring countries such as Taiwan or Japan, if there is a Neville Chamberlain among us. Be aware of China's territorial ambitions!

Samuel Wu
Taipei

Disappointment

AS A LONG-TIME subscriber to the REVIEW, I'm disappointed that you continue to print articles written by Gordon Chang. As a U.S. citizen with 13 years' experience in China (and now living here permanently), I have serious disagreements with Mr. Chang's references to history, selective quotes, unsubstantiated comments and conclusions.

THE FAR EASTERN ECONOMIC REVIEW welcomes letters to the editor sent via fax to (852) 2503-1530, by email to letters@feer.com or by post to GPO Box 160, Hong Kong. Submissions must include the author's full name, address and daytime contact numbers. The REVIEW reserves the right to edit letters for length and clarity.

For a selective and short example: "...as China has grown more prosperous, it has also become less stable. In fact, there were 58,000 protests in 2003, 74,000 in 2004, and 87,000 last year according to official statistics." In fact, couldn't this mean that citizens have more confidence to right the wrong of corrupt governments? Where are country comparative statistics?

There are so many other rationalizations that he uses in this article it would take another article to respond to them fully. I hope readers of the REVIEW will not be tempted to buy Mr. Chang's book. It is pure sensationalism.

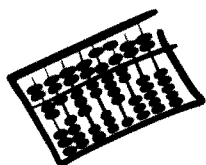
Warren Barshes
Beijing

Nationalism in Japan

KAZUHIKO TOGO IS wrong to say that the Japanese prime minister should not visit the Yasukuni Shrine ("A Moratorium on Yasukuni Visits," June 2006). The Chinese government is using this issue in a deceptive way to hurt Japan. If the visits stop, they will find something else to complain about. Japan will always be in a "no win" situation with the Beijing government unless it takes a firm stand. China constantly lectures other countries that they shouldn't interfere in its internal affairs. Why can't it abide by its own rule?

Furthermore, it is foolish for China to put this pressure on Japan. Doing so only stirs up the right-wing forces within Japanese society which otherwise would gradually fade away. Now they are getting a new lease on life because of China's provocation. Is this really what Beijing wants?

Tsuyoshi Sano
Tokyo



Outsmarting China's Start-Arounds

by Steve Ellis and Orit Gadiesh

O PINIONS REGARDING China's economic rise have generally been shaped by two hard-to-ignore numbers: one is the country's current labor cost advantage, which is as much as 95% over multinationals in the U.S., Europe, Japan and South Korea; the other entails the prediction that in 30 years, China will become the world's largest economy.

Chinese policy makers certainly know the direction they want to go in. Today, China is home to 16 of the world's top 500 companies; the country is aiming for as many as 50 by 2010. But what path will they take?

Looking back on how Japanese and South Korean companies became global leaders, a common trajectory emerges with three distinct phases: They built local manufacturing, often in order to provide low-cost sourcing to multinationals; they borrowed capabilities through technology

licensing and joint ventures to improve quality and processes and begin exporting; and finally, they bought assets and brands abroad to secure their global positions.

China will likely incorporate a similar buy, build and borrow strategy. But the economic engine that is accelerating the country along this familiar pathway is not well understood. Indeed, a distinctly Asian paradox underlies this growth, where stunning economic achievements are fueled by both entrepreneurial successes and, at the same time, great turnaround efforts.

As commonly understood, entrepreneurial—or start-up—implies beginning from zero, creating a climate that fosters innovation, unencumbered by corporate culture or history. Turnaround, by contrast, implies a concerted top-down effort, through central planning, to overcome

Mr. Ellis is the worldwide managing director and Mr. Gadiesh is chairman of Bain & Company.

burdensome elements of the past, adapting to a changing environment with the will to endure the painful effects of massive change.

Harnessing Contradictory Economic Forces

THESE CONCEPTS WOULD seem mutually exclusive. And yet, Asia's recent economic history bears out how these forces can be combined and multiplied into what we call a "start-around" approach. Indeed, one Asian country after another has devised its own unique method of combining start-up and turnaround activities to create some of the most impressive economic growth stories of the last century. Far from being contradictory, such centrally managed turnaround policies, yoked to the free pursuit of entrepreneurial wealth, reinforce each other.

Understanding this duality, one can see how the start-around pattern has repeated itself over and over, first in Japan, which combined MITI policies with free market trade, and then in Asia's "Four Tigers." But the standout example of the start-around is China, where an ancient culture has become the foundation of a colossal turnaround, and where a stagnant communist economy has been transformed by a booming capitalistic start-up culture. Indeed, China is probably the best example of an Asian nation that has allowed free market forces to create entrepreneurial energy while maintaining the influence of a centrally managed economy. China is truly the start-up of all start-ups and the turnaround of all turnarounds.

China has opened its once-rigidly controlled economy in a way that has allowed both domestic Chinese and foreign nationals to flourish, deftly handling the conflict between communism and capitalism by brushing economic ideology aside. Reverting to the pragmatism of their ancient culture, they are pushing their nation towards modernization, not Westernization. To quote Deng Xiaoping, "It doesn't matter if the cat is black or white, as long as it catches mice." While many difficult issues remain as China's economic revolution continues to gain speed, its leaders clearly understand the power of the start-around concept.

The corollary is that multinational corporations must also comprehend how economic energy is unleashed by China's start-around efforts. Today's global champions are already up to speed in the most important areas of business competition such as understanding customer needs, managing global supply chains, creating and motivating world-class talent and ensuring a steady supply of on-target innovations. But they need to accelerate their own growth to stay out in front.

Firing on All Cylinders

TWO HIGH-GROWTH CHINESE companies exemplify how start-around policies reinforce each other. State-run Shanghai Automotive Industry Corp. began as a manufacturer of farm tractors and since 1984 has grown into a global player through government-negotiated joint venture agreements with Volkswagen and General Motors. It plans to expand production

China is compressing the three distinct phases of building, borrowing and buying into one push.

four-fold over the next 15 years. Its leaders, in fact, are aiming to make Shanghai Automotive one of the world's six largest automakers by 2020, joining GM, Toyota, Ford, DaimlerChrysler and Volkswagen.

The company has developed its own top-down/bottom-up market strategies to get there. In China, it will continue to grow in conjunction with Volkswagen and GM. To blunt challenges from regional rivals, it has taken a stake in South Korea's Ssangyong Motor. And in a bold bid for growth, in 2004 it attempted to buy the United Kingdom's Rover Group, eventually settling on the purchase of two Rover models it now sells under their own brand.

To gain scale and knowledge, Shanghai Automotive plans to exploit its burgeoning home market. According to Shanghai Automotive Chairman Hu Maoyuan, the company hopes to manufacture two million vehicles by 2010, including 1.5 million cars for Chinese buyers. Their own modest passenger car is set to hit the Chinese market by 2007. "With the increase in private buyers, the market potential is very huge," Mr. Hu says.

Just how huge? Recent data show that in the U.S. there are 940 vehicles for every 1,000 people of legal driving age; Japan has 502. In China, however, with a population five times larger than America's, that number drops down to eight.

Baidu.com Inc., by contrast, began as a start up, but is already well into its next phase of growth. Although it has faced government censorship over the contents

of its portal, China's most popular search engine has nevertheless developed in an almost purely capitalistic form. Often called "China's Google" (having surged ahead of the popular global search engine in China), Baidu.com made its debut on Nasdaq in August 2005. Its shares skyrocketed to a closing price of \$122.54, more than 2,000 times the portal's 2004 per share earnings. Indeed, no other tech company—in any nation—has received such a response from investors since the glory days of the Internet.

Today, Baidu.com commands the loyalty of about one-third of China's more than 100 million Web surfers. Founder Robin Li thinks this is only the beginning: "Although 100 million is a huge number, it is less than 10% of the population of this country, so the network effect is not fully developed yet," Mr. Li told the U.K.'s Guardian newspaper. "There is a lot of room to grow. That is why I am more focused on long-term investment than short-term profits." To succeed at this next phase of growth, Baidu.com is already looking to "start-around" its search-engine capabilities, enhancing its core offering at a time when its competitors are concentrating on portal content such as news and entertainment.

Cranking Up the Tempo

BAIDU.COM AND SHANGHAI Automotive are examples of how companies in China have not only learned how to harness the power of start-around policies, but have done so

with incredible speed. For the main difference between China's recent economic history and that of its Asian predecessors is simply the overwhelming rate at which this is now happening. To prepare their defenses, today's global leaders will need to understand how China is leapfrogging ahead.

Perhaps the apotheosis of China's rapid emergence is Lenovo, now the world's third-largest PC manufacturer. Confronted with its ubiquitous marketing blitz—it seemed as if Lenovo single-handedly sponsored the 2006 Winter Olympics, and it recently hired Brazilian football superstar Ronaldinho as part of its intensive World Cup campaign—it is easy to forget that Lenovo only began laying the groundwork for overseas expansion in 2003.

Like Japan's MITI in the 1980s, China's leaders are steering a course for expansion, only at almost breakneck speeds. What's turbocharging the effort is China's deft synchronization and fusion of Asia's traditional growth steps. In the past, companies largely completed one phase before making a clear transition to the next. Not China: It's compressing the three distinct phases of building, borrowing and buying into one simultaneous push.

Japan's Sony, for example, despite first entering the U.S. market in 1960, did not burst onto the world scene until the Walkman hit stores 19 years later. After that, Sony gradually added unique businesses through acquisitions only where it wanted to test synergies with new products and customer segments adjacent to its core business: In 1988 Sony purchased CBS Records, and in 1989 Columbia Pictures was

acquired to provide content to support Sony's devices.

Similarly, South Korea's Samsung Electronics, founded in 1969, was developed through export-driven growth. In 1972, it began exporting electronics, and by 2004 it was the world's largest producer of semiconductors and one of the leading producers of monitors and televisions. Yet while Samsung built an overseas plant in Portugal in 1982, it wasn't until 1988 that the Korean firm established its first joint venture, in France, to sell products overseas.

Lenovo, on the other hand, has cut decades from the process of building organically, borrowing capabilities strategically and buying globally. Founded in 1984, the company then known as Legend began as a distributor of foreign-brand PCs, including IBM and HP. It started creating its own PCs for the Chinese market in 1990, and throughout the decade borrowed innovations through more than a dozen joint ventures with the likes of AOL and Microsoft. But its export drive didn't begin in earnest until 2003 with the launch of Lenovo. Since then, it's been in hyperdrive, leaping ahead of the global competition last year by acquiring IBM's PC unit, becoming the world's third-largest PC manufacturer and moving its world-wide headquarters to the U.S.

As Chinese firms like Lenovo continue to push into markets around the world, this growth tempo will only accelerate, and the government is doing its part to quicken the pace. Chinese companies seeking to invest offshore, for instance, formerly had to apply for special approval from the government; but Beijing recently signaled that this cap will be abolished

sometime in 2006, which is likely to trigger a buying spree among Chinese firms.

Ways to Stay Out in Front

IN RESPONSE TO China's start-around economic growth, multinationals must adjust their strategies accordingly and play to their own strengths. Yes, it's important to learn how to manage costs to meet the competitive threat from China. But in areas such as low-cost manufacturing and speed to market, companies already know they have to be at par or outsource to compete. The best way for global firms to defend core markets, then, is to focus on areas where Chinese firms still have a lot to learn.

Most important, of course, is building customer loyalty. This entails addressing the needs of both the end consumer and intermediate distributors. Although Chinese companies have historically dealt with fewer distribution partners—relying instead on megaretail channels—even in this regard Chinese companies are closing the gap, in part through the acquisition of non-Chinese firms. But customer insight takes time to develop.

Second is innovation. Many industries appear to be on the path to becoming commoditized, with limited freedom to innovate. But in reality, leading players are finding their own ways to differentiate themselves. Innovations do not have to come as breakthroughs in engineering, but can also arise from new methods of production or sales. In the past, industry leaders tended to become lazy with customers and innovation, giving rise to opportunities for emerging players in Japan and Korea. Lead-

ing corporations today should not repeat this same mistake with the Chinese.

Multinationals must be willing to empower their frontline and factory floors to calculate risks, and their business units to set high standards for new and innovative products, developing faster product cycles in major markets. They should encourage customer, supplier and even competitor collaboration on research and development, looking outside—even beyond their own industry for innovation. Don't just build innovation—borrow and buy it, all at once. That's what Chinese firms are doing.

Third, multinationals need strategies for developing talent that optimize diversity in skills and experience. The battlefield for talent will be critical and will require people with global experience. The most successful global companies will be those that motivate their front line through distributed leadership, rather than command-and-control.

Patience Is a Virtue

SUCH STRATEGIES ARE likely to lift the global competitive playing field. But, in the end, the race will not be won by the swiftest. Rather, it will go to those that endure the longest. The centuries have taught China's people to be patient, which is yet another ingredient fueling its growth. As Deng once put it, all of China will get rich, but "Let some people get rich first." With their emphasis on quarterly earnings, today's multinational leaders have yet another lesson to learn from their fast-approaching Chinese rivals: the idea of thinking forward in decades. ■



How China Can Break Down America's Wall

by David M. Marchick and Edward M. Graham



AS THE JAPANESE swallowed up American companies and assets during the 1980s, members of Congress, union leaders and business executives began proclaiming with anxiety "The Japanese are coming!" Although foreign investors had played an important role in the development of the U.S. economy—especially during the late industrial revolution from the 1870s to 1914—critics warned that, when it came to Japan, something was different. Some, including Lester Thurow, then Dean of the MIT Sloan School of Management, and Steve Forbes, publisher and later presidential candidate, worried that growing Japanese economic clout might seriously threaten the future wealth and power of the U.S. "Some people seem to worry that they will pick up the phone," observed MIT economist Rudiger Dornbusch in 1988, "and the guy at the other end of the line will be saying 'moshi! moshi!'"

Now, 20 years later, similar arguments are being applied to investments from China. Despite the fact that both Republican and Democratic administrations have long encouraged China to liberalize its markets, there is growing anxiety in Congress about increased Chinese investment into the U.S.

But what lessons can Chinese investors glean from the Japanese experience? Should Chinese investment in the U.S. be treated any differently than investments from other countries?

In response to growing hostility, Japanese corporations in the 1980s implemented various strategies to gain acceptance in America. Since most official criticism came

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from Congress and not from the state or local level, many Japanese companies, including Nikon, Sony, Panasonic and Toshiba, set up or expanded offices in Washington to foster a more positive image for their companies. Today, 37 Japanese corporations operate such offices in Washington, making Japan the third most represented foreign country in the U.S. capital.

For cultural reasons, however, Japanese companies have been less aggressive than U.S. companies in their outreach strategies. Instead, they try to shape opinion in Washington by working with third parties such as think tanks, journalists and former government officials. In particular, Washington think tanks began in the middle 1980s to host forums on Japanese investment, producing studies demonstrating its economic benefits. Japanese companies in many cases contributed to these studies, both by helping directly to fund the think-tank activities, and by cooperating with the scholars performing these studies. This practice continues to this day.

Thus Japanese firms were able to show that, contrary to the fears of many, Japanese companies investing in the U.S. often hired Americans in top executive positions and, moreover, bought inputs from U.S. producers. In 2002, the Bureau of Economic Analysis reported that Japanese companies had created over 834,000 jobs in the U.S. Automaker Honda alone employs over 27,500 Americans and has an annual payroll of \$1.69 billion; since 1982, the company has increased its number of U.S. suppliers to over 550 from 40. And it's not alone: Toyota's purchases of parts and

materials from North American suppliers now exceeds \$11 billion.

Japanese companies also worked to build support at the local level. Though warmly received by many state governors, such as former Governor of Tennessee Lamar Alexander (now a senator), who successfully courted investments from both Nissan and Komatsu during the 1980s, Japanese companies nevertheless worked to integrate themselves into countless local communities. Following the mantra, "produce where you sell," Japanese companies helped ease fears that their investments were simply conduits for imported goods. For example, Honda's engine plant in Ohio is the company's largest in the world, producing more than one million engines per year; and Toyota's West Virginia plant became the first outside Japan to build Toyota's automatic transmissions in 2001. Responding to Toyota's investment of over \$220 million in a V8 engine plant in Huntsville, Alabama, Governor Don Siegelman proclaimed in 2001 that the "partnership between Toyota and Alabama provides hope and dreams of a better quality of life to Alabama families."

In San Antonio, Texas, where Toyota opened a large plant, the firm donated over \$500,000 to local foundations, including the San Antonio Economic Development Foundation and the San Antonio Education Partnership. Similarly, Sony Pictures Entertainment partnered with Culver City Schools in California to provide new educational equipment, faculty training and student mentoring. Sony employees themselves planted trees, painted murals and created a butterfly garden for the sixth

grade science program. "Thanks to our partnership with Sony Pictures Entertainment," said Dr. Laura McGaughey, superintendent, Culver City Unified District, "the Culver Academy [of Visual and Performing Arts] has become a leader in arts education and a place where students can pursue their dreams."

These stories are not unique. Throughout the U.S., many Japanese companies have contributed to local community development. They have donated millions of dollars to local organizations ranging from little league baseball teams to pediatric cancer research centers. In doing so, Japanese companies were in fact emulating the strategies of U.S. companies—invest, build community support, court local politicians and broaden the economic benefits associated with their investment.

Image Makeover

THESE STRATEGIES EMPLOYED by Japanese companies to weave themselves into the fabric of the U.S. can provide useful lessons for Chinese corporations as they attempt to navigate the same waters as Japanese companies did 20 years ago. As with Japan in the 1980s, Congress and the administration are concerned with the growing competitive position of China, the huge bilateral trade imbalances and China's export-led growth strategy.

At the same time, there are important differences between the Japanese and Chinese investment trends. For example, one of the main criticisms of Japanese investment was that the Japanese economy was closed to foreign investment. By con-

trast, while significant problems remain, China is not closed; rather, it is the second largest recipient of foreign investment in the world. U.S. investment alone in China at the end of 2004 exceeded \$15.4 billion, and this almost surely understates the true amount.

Further, most U.S. concerns with Japanese investment in the 1980s focused on economics, whereas concerns with Chinese investment are based on a mixture of economic and national security-based issues. Of America's top 10 trading partners, only China is not considered a strategic and political ally. The other nine are either members of NATO, have U.S. troops on the ground, enjoy a free trade agreement with the U.S. or are recipients of American arms exports.

And whereas Japanese investors in the U.S. were privately owned, the Chinese government owns or controls most of the Chinese companies with the wherewithal to invest abroad. A recent study estimates that of approximately 1,300 publicly listed companies in China in 2004, only about 20 were genuinely private; the rest were all ultimately controlled by the state.

Government ownership of companies often raises questions of whether they will make decisions based on commercial interests or national interest. Given America's strategic concerns with Beijing, the fact that so many Chinese companies are controlled by the state will result in exacting scrutiny of Chinese investments under the U.S. government process for reviewing the national security implications of foreign investments. This process, conducted by the 12-agency Committee on Foreign

U.S. agencies worry that Chinese companies might be used as covers for intelligence operations.

Investment in the United States, was created in 1988 at precisely the time when Congress was concerned about growing investments from Japan.

But government ownership is not the only factor likely lead to extra scrutiny by CFIUS. The possibility of sensitive, export-controlled technology being transferred to other countries is a factor in virtually all reviews by the committee, regardless of the home country of the acquirer. It is a concern in the case of Chinese acquisitions largely because of a series of high-profile breaches of U.S. export-control laws and regulations by Chinese companies in the late 1990s and early 2000s. China's espionage activities have become a concern to U.S. counterintelligence agencies, including the Department of Justice, Defense, and Homeland Security, as well as the Federal Bureau of Investigation. These agencies are worried that certain Chinese companies might be used as covers for intelligence operations. So long as the Pentagon views China suspiciously, CFIUS will likely assess Chinese acquisitions of U.S. companies in part on their impact on China's military strength.

Chinese acquisitions may also present different economic issues for U.S. policy makers to consider. For example, whereas a significant number of Japanese investments flowed into the U.S. manufacturing sector as greenfield investments, Chinese companies have many comparative advantages, including low labor costs, in manufacturing and already have significant

access to the U.S. market. Chinese companies may be less interested in establishing a manufacturing base in the U.S. than in developing globally competitive management skills and global brand names. Moreover, Chinese companies are keenly interested in acquisitions in strategic sectors, including energy—precisely those sectors that may raise political or national security issues in the U.S.

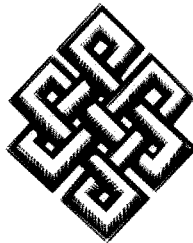
Even so, most Chinese investments in the U.S. would not trigger CFIUS reviews, required mainly when foreign investments are made in sectors that potentially implicate U.S. national security interests. When the Chinese company Haier considered purchasing U.S. white goods manufacturer Maytag during the summer of 2005, for instance, Haier did not have to submit the acquisition for CFIUS approval. Similarly, most Chinese investments in the retail, real estate or auto sectors would not require national-security reviews.

But no matter what sector they operate in, Chinese companies will need to become more sophisticated in addressing the potential political opposition that may arise if they wish to be successful in their efforts to enter the U.S. market. They will need to demonstrate their commitment to creating jobs, complying with U.S. laws and regulations and being good employers. They will need to become involved in their communities in the same way that the best American companies do. Chinese companies would benefit from gaining experience in investing in the U.S. by investing in sectors

that would not be seen as sensitive from a national security perspective. To maximize their chances of earning satisfactory returns in America, Chinese companies should concentrate on investing in activities where they have demonstrable intangible assets—e.g., better product or process technologies—that local rivals do not possess (as did the most successful Japanese firms).

For its part, the U.S. should continue to support China's integration into the global economy, and Chinese outward foreign in-

vestment should be viewed as a natural and positive step in China's economic development. A U.S. policy that encourages American companies to invest in China but frowns upon Chinese investment in the U.S. is neither sustainable nor sound from an economic or national interest perspective. The U.S. should simultaneously encourage China to continue to allow FDI to flow into its own economy and in parallel welcome Chinese investment in the U.S. By doing so, the U.S. itself will benefit, as will China. ■





Getting It Wrong In East Timor

by A. Lin Neumann



FOR ANYONE INVOLVED in the brief flurry of “nation building” that swept through East Timor a few years ago, it is sad to watch the tiny nation teetering now on the brink of collapse. The international aid community, led by the United Nations and various donors and agencies, believed that a quick application of money and expertise could overcome centuries of neglect and Indonesia’s heavy-handed occupation. East Timor, it was hoped, would become a beacon of hope and democracy on the fringes of Asia.

The inescapable conclusion, however, is that the international effort has fallen short. The U.N. left the Timorese with an unpopular, undemocratically elected government that failed to listen to its own people and heal brutal political divisions. The new government banished the Indonesian language and reverted to Portuguese—spoken only by the tiny landed elite

in the country—and a minority local tongue, Tetum, resulting in an entire generation educated by the Indonesians losing touch with the government.

Desperately poor, with little in the way of resources other than the perpetual promise of offshore oil, the situation has now rapidly deteriorated to the point of prolonged crisis. The likely outcome is that the U.N. will have to step in once again with a long-term effort to repair the damage done.

Tragically, you could have seen this coming. International consultants knew the peace was ephemeral and the job incomplete. When I was working in the capital, Dili, from 2000 to 2002 training journalists and serving as a media ombudsman on behalf of the U.N., I had frequent conversations about the festering

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social and political divisions. Many, including significant elements of the church and human-rights groups, saw recently resigned Mari Alkatiri's assumption of power as prime minister as nondemocratic. The Timorese army was also seen as having been put together without adequate thought given to potential ethnic and political rivalries.

Largely forgotten by the world since independence in May 2002, the infant state reappeared in the media only after Mr. Alkatiri sacked about a third of the army in March—almost all of them soldiers from the west of the country—triggering widespread claims of discrimination. This ignited a rebellion by the dismissed soldiers that led to clashes and gang wars on the streets, killing 21 people. About 2,200 peacekeepers from Australia, New Zealand, Malaysia and Portugal soon arrived to quell the violence and restore order. In Dili alone, more than 130,000 people were displaced by fear and chaos.

President Xanana Gusmao had called on Mr. Alkatiri to step down, to help ease tensions. But the divisions are far from healed. While Mr. Gusmao's supporters celebrated the resignation, the ruling Fretilin Party massed thousands of supporters in Dili to claim that Mr. Alkatiri had been unjustly removed. "What is going on is going on by undemocratic means and is against the constitution," Mr. Alkatiri told the crowd just two days after he resigned on June 26. "We must show we are still the party of strength." Following the rally, more clashes broke out in the streets of the capital. No successor to Mr. Alkatiri, who has alleged in interviews that those who oppose him

are plotting on behalf of foreign powers, was readily apparent, and a period of continuing instability seems inevitable.

It did not have to be this way. After a wholesale sacking of the territory by departing Indonesian soldiers and their local militia supporters, East Timor was to start afresh. Once the fires died down, the international community descended in force: The U.N. administration, led by the charismatic Sergio Vieira de Mello (who would later die in a terrorist bombing in Iraq), would for the first time create a nation almost from scratch. Aid agencies and legions of experts arrived to rake over the coals and assist in the establishment of a constitutional government, a professional army, a police force and a free press—all the trappings of a legitimate state.

But the international community failed to follow through by providing the fledgling country with adequate democratic institutions. What is more, they misguidedly acquiesced to the demands of an authoritarian ruling clique, and then left prematurely.

The Timorese were left to fashion a state from the embers of political rivalries dating back to a brief period of civil war that preceded the 1975 invasion by Indonesia. With Portugal keen to assuage guilt over its inept departure from the territory in 1975, Mr. Alkatiri and his well-trained, Portuguese-speaking allies quickly found financial support. And with people outside Dili believing them to be the only party of independence, Fretilin easily limited the chances of any significant multiparty system emerging from the Constituent Assembly elections of 2001.

Foreign donors are saying we won't hold you accountable because of your difficult past.

With better organizational ability, Mr. Alkatiri's party also took on the dominant role in drafting a constitution that was put in place without a popular referendum. The charter gave the transitional Constituent Assembly, dominated by Fretilin, the power to convert itself into a parliament. Fretilin then used this power to appoint Mr. Alkatiri prime minister.

In the rush to independence, simmering tensions between the Fretilin party and other factions were papered over. Now these tensions have reached a boiling point. Repairing the damage will take a long time.

"I blame all the Timorese leadership, which has spent more time flying around the world first class than dealing with internal problems," said a former U.N. official who served in Dili for several years. "And I blame the U.N. for leaving so precipitously after independence and for not supplying sufficient long-term funding and staffing to really train the defense and police forces and create a competent civil service."

Perhaps out of sympathy for the plight of the Timorese—some say as many 200,000 people died from war and starvation during the Indonesian occupation—political leaders, mainly veterans of the Fretilin liberation movement, were allowed to rig the game in their own favor, creating a climate of opaque governance and an atmosphere of distrust and division. An expert still active in the country complained, "It's almost as if foreign aid donors have been saying to the Timorese,

'We won't hold you accountable for your behavior in the same way that we hold other countries accountable because of the shitty past you have had.'"

"This rivalry issue would have not taken place if the U.N. had taken the country through a political reconciliation process to encourage a more unified government," said Sebastiao Guterres, a Timorese journalist who has worked with both the U.N. and the World Bank. "The parties had no time to recover from their old wounds."

Now, in the aftermath of the chaos that has engulfed Dili since May, the situation seems only to be growing murkier. Prosecutors ordered the arrest of former Interior Minister Rogerio Lobato, who resigned on June 1, accusing him of supplying guns to the leader of a hit squad allegedly commissioned to silence members of the opposition. Mr. Alkatiri has been similarly accused, though he denies the charges. Nobel laureate Jose Ramos Horta, the foreign minister, assumed the defense post in an effort to calm the turmoil and may yet become prime minister in an interim government.

The only political leader with credible popularity, Mr. Gusmao, is left with the task of trying to reunite the country, repair a difficult relationship with Fretilin, cope with other divisions in the government and try to keep a lid on the violence. He will have to draw heavily upon the political capital he gained during the occupation, when the resistance broadened under his charismatic leadership, incorporating many non-Marx-

ist and centrist elements. After he went to prison in Indonesia in 1992, Mr. Gusmao began to take on a Nelson Mandela-like role. But he will have to act without substantial executive powers, since the constitution drawn up under U.N. guidance made the presidency a figurehead position, placing the lion's share of power in the hands of the prime minister. Perhaps he will be aided by Mr. Horta, who spent the occupation in exile while Mr. Gusmao was in the hills or prison, but their relationship has not always been easy.

The international advisors who swooped into Timor failed to understand the depth of the political rivalries that existed in the country, said Mr. Guterres. "The recent breakdown of order is due to the fragile establishment of the police and other sectors. There was a division of command and leadership and too much distrust."

It is a recipe for continued instability and uncertainty. The U.N. Security Council formally extended its East Timor mission for two months on June 21 and asked for a report on sending U.N. peacekeepers back to the country. Unrest in East Timor has "serious humanitarian repercussions," the Security Council said in a resolution. Mr. Horta has said that a U.N. presence will be necessary for at least a decade. The U.S., which backed an early withdrawal from East Timor, has reversed course and said it will now push for an extended U.N. mission to repair the damage done by the fighting.

Sadly, the return of peacekeepers to quell the latest violence came almost ex-

actly one year after the last U.N. troops pulled out of Dili—a move largely pushed by the U.S. in the U.N. It now seems that even the symbolic presence of those last hundred or so troops provided an atmosphere of stability. New resolutions from the U.N. will have to restore a peacekeeping presence for some time and reinvigorate the democracy machine ahead of next year's scheduled elections and beyond.

"If we define 'failed state' as one where there is a total economic collapse and a complete lack of ability of the government to command authority, then I think we can fairly say that East Timor is failing," said a Western political advisor with many years of experience in Timor. Along with others interviewed, the advisor is calling for the return of a strong U.N. mission to supervise elections, overhaul key government ministries and stabilize the country. In addition, an international investigation of the current unrest is desperately needed, and the army and police need to be reformed and reconstituted.

Said another former U.N. official and aid worker, "There needs to be a serious rethinking about how this kind of assistance works. Too often the decisions about what needs to be done are taken by international consultants who have little or no knowledge or understanding of the country concerned and with no serious consultation with that country's citizens."

The world failed East Timor in 1975 after the invasion by Indonesia, and again in 2002 by leaving a job half done. It must not be allowed to fail a third time. ■



Abdullah's Imperfect Plan

by Colum Murphy



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HE RECENT mudslinging by former Prime Minister Mahathir Mohamad at his successor Abdullah Ahmad Badawi has en-

thralled Malaysia almost as much as the 2006 World Cup. Not since he dumped his former protégé, Anwar Ibrahim, has Mr. Mahathir's vitriol been so potent.

Mr. Mahathir has accused Mr. Abdullah of incompetence and "stabbing him in the back" by halting some of the large projects begun when he was leader, including the plan to replace the causeway linking Malaysia to Singapore.

At stake is more than hurt feelings. Mr. Mahathir and his cronies are not happy with Mr. Abdullah's approach to overhauling the Malaysian economy. In March, Mr. Abdullah announced the first installment of his blueprint—the \$60 billion Ninth Malaysia Plan, or 9MP, which covers the five-year period 2006-10—aimed at keeping Malaysia on track to achieve its much tout-

ed goal of becoming a developed country by the year 2020. While the goal is consistent with the "Vision 2020" slogan coined by Mr. Mahathir, there are some notable differences in Mr. Abdullah's approach.

Gone are the graft-prone giant infrastructure projects of the 1980s and 1990s, and in their place the government is investing in human capital. This shift to a "people focus" is an attempt to ensure that Malaysians have the skills and attitudes needed in a global economy. In a further break with the past, the Abdullah administration is also showing a greater willingness to liberalize Malaysia's economy: An economic partnership agreement with Japan will go into effect later this month, and trade negotiations with the U.S. are already underway and are expected to result in a free trade agreement by early 2007. Consolidation of the banking sector is also ongoing, and new rules allow for higher foreign

— Mr. Murphy is deputy editor of the REVIEW.

ownership in banks. Reform of government-linked companies such as the energy provider Tenaga and communications company Telekom is under way.

Not that all trademark elements of meddling in the Malaysian economy are being jettisoned. Khazanah, the government's investment arm, is becoming more ambitious, investing in strategic assets both at home and overseas. Mr. Abdullah still clings to affirmative action for the mainly Malay *bumiputra*. The blueprint reiterates the goal of putting 30% of Malaysian equity in *bumiputra* hands by 2020.

Malaysia, Which Way?

MALAYSIA FACES REAL long-term challenges. The economy grew by a respectable 5.3% in 2005, according to the country's central bank, but that's considerably lower than the average 8% growth rates of the mid-1990s. Mohamed Ariff, executive director of the Malaysian Economic Research Institute, an independent think tank that acts as consultant to the government on industrial policy, says the days of heady growth are over and it is time for new ideas and fresh approaches.

As elsewhere in the region, change is being driven by globalization, mainly in the form of a rising China. For now, Malaysia is benefiting from China's explosive growth by feeding mainland factories raw materials and components. China is now Malaysia's fourth most important trade partner after the U.S., Singapore and Japan, and last year bilateral trade between the two countries was 85.1 billion ringgit, or around \$23 billion. This is expected to

more than double by 2010.

In the long term, Malaysia has little hope of competing with China, at least in lower wage manufacturing. And even if Malaysia moves up the value chain in manufacturing, Mr. Ariff says, that will only stave off the inevitable. "It will take 10 to 15 years, but eventually China is going to catch up," he says. The challenge is for Malaysia to find new growth areas, and build an economy that is not on a "collision course" with China. This includes reducing dependency on manufacturing to 20% to 25% of GDP within 15 years, from the current level of around 32%. Services should increase to around 65% from 58% in the same period, says Mr. Ariff.

The 9MP, and the related Third Industrial Master Plan (IMP3, expected to be released shortly), are supposed to help by pushing high-technology, knowledge-intensive activities with high value-added content in areas like electronics, petrochemicals, biotechnology, aerospace and maritime, according to Senator Effendi Norwawi, the minister in the prime minister's department responsible for the 9MP. On services, the goal is to spread the sector out from its traditional base in greater Kuala Lumpur, with Johor being eyed as a regional services hub. In particular, tourism, health services, financial services and education will be targeted for growth, the senator says. For the first time in a long time, a strong focus will be placed on developing agriculture and related industries.

In Penang, the China threat has been around for years. That's hardly surprising, given that around a quarter of a million Penangites—out of a population of 1.3 mil-

Abdullah is a product of the system. Can he can break the mold and think outside of the box?

lion—are employed in the cutthroat electronics sector, in which China's profile increases with each passing year. While defections to China are occurring, the sector still seems reasonably healthy. Even so, there is a feeling that doom is on the horizon and moving up the value chain has become a mantra.

Wong Siew Hai, the retired head of Intel in Penang and current chair of the Malaysian American Electronics Industry association, explains: "In the past, 60% of these jobs were direct labor and 40% were indirect labor such as engineering, planning and human resources." The aim is to reverse those figures, he says. Mr. Wong believes Penang's electronics industry must concentrate more on R&D, marketing, and product design for semiconductors, microelectronics and software development.

But first, Malaysia needs highly skilled graduates. Currently, there are a reported 60,000 Malaysian university graduates who are seeking work, largely because of a mismatch between university curricula and employer needs. In the case of the electronics industry, for example, Mr. Wong says there are only one or two universities in the whole of Malaysia that have graduate-level programs in new technologies such as semiconductor design.

Mind the Mindset Gap

IT IS PRECISELY these gaps that Mr. Abdullah hopes to fill under 9MP. He warns against having a first-class physical infra-

structure with a third-class mentality. The goal is a labor force that has the ability and attitude to excel in a globalized world. It sounds a bit nebulous, but a first step is to pour money into revamping the education system—no less than 40 billion ringgit, or roughly 20% of the total 9MP expenditures, is earmarked for this.

It would be hard to find fault with greater investment in education as long the money is spent properly and the goals are achieved. But throwing money at universities is not going to be enough. In a globalized world, knowledge workers also need the right attitudes: flexibility, tolerance, and the ubiquitous ability to "think outside the box"—attitudes, some say, that are sorely lacking among Malaysians. It is for this reason that Mr. Abdullah's plan hopes to instill "progressive attitudes and thinking, strong moral and ethical values" in its citizens—all under the auspices of *Islam Hadhari*, or Civilizational Islam, a development framework that "emphasize[s] faith and piety, a just and trustworthy government, and balanced, comprehensive economic development."

The introduction of such abstract concepts in an economic plan has left many observers bewildered. In Mr. Mahathir's time, it was easy to understand what was going on—Malaysia was building a lot of really big things. Mr. Abdullah, however, is leaving himself wide open to criticism because attitudinal changes are not only hard to achieve but hard to measure.

There are several possible explana-

tions put forward for Mr. Abdullah's insistence on including such high-concept ideas in his plan. One school of thought says that this is just rhetoric meant to soothe those who lament the loss of Malaysia's Islamic soul. The second school says the concepts are clues to Mr. Abdullah's underlying intentions. Said one economics professor at a public university in Penang: "What makes the 9MP plan especially challenging is how to get people to read between the lines."

But divining Mr. Abdullah's intentions is not easy. One big focus of the plan is "integrity," a clear a nod to the government's anticorruption drive. But grasping his true intentions on the thorny issue of affirmative action is trickier.

On the one hand, the plan clearly states that "during the Ninth Plan Period, the distributional agenda will be pursued more firmly so as to ensure the achievement of a more equitable distribution of the benefits of economic development by all Malaysians." The plan also brings back the controversial issue of bumiputra equity ownership after it mercifully faded into the background over the past few years. The goals have now been restated unequivocally: Bumiputras should hold between 20% to 25% of Malaysian equity by 2010, and 30% by 2020. The figure was around 18% in 2004 but realistic figures on equity holdings are notoriously hard to find. Similarly, the government wants to increase bumiputra ownership of residential, commercial and intellectual property.

In addition, the government also wants to reduce income disparity between bumiputra and nonbumiputra ethnic groups.

Chinese Malaysians, for instance, typically had incomes 64% higher than bumiputras in 2004; the 9MP wants that reduced to 50% by 2010. With huge chunks of the Malay community unable to join the middle class, income disparities between "have Malays" and the "have-not Malays" is also a concern, albeit one that, for obvious reasons, politicians would prefer to play down.

There is a fundamental contradiction here. Mr. Abdullah wants to create a more competitive Malaysia yet he supports strategies that protect the bumiputras. Abdul Razak Baginda, executive director of the Malaysian Strategic Research Center, not only considers the goal of 30% equity ownership as "meaningless," he is concerned that affirmative action does more harm than good. The initiatives first set down in 1970 have been good for middle-class Malays, he says, but they have also had "the unintended result of Malays losing competitive ethos."

The government would argue that ensuring equitable income distribution is the only sure-fire way of keeping Malaysia stable and avoiding a return to the times when racial tension erupted into violence. But without economic growth, there can be no redistribution of wealth. If Malaysia turns too readily to affirmative action it runs a risk of creating a workforce that falls down in the face of more competition-driven economies. In short, Malaysia, can't expect to be competitive in external markets if it is protectionist in the domestic market.

Proponents of "reading between the lines" caution against taking Mr. Abdullah's bumiputra stance too literally. Instead, they point to the emphasis on

morals, ethics and integrity. This, some say, is a subtle hint to segments of the Malay population that might see themselves losing out—letting them know they must fend for themselves if they wish to partake of the benefits of growth. Some interpret the plan as a call to the bumiputras to take greater responsibility for themselves, and say that in a very quiet way the plan offers hope that the government is prepared to, if not abandon, at least tone down affirmative action.

However, this sounds a lot like wishful thinking, and the main flaw of the plan remains the tension between aspirations to first-world thinking and an unwillingness to take the painful steps to create an open, vibrant and competitive Malaysia. “We keep telling the government that the space for affirmative action is getting more and more limited,” says Mr. Ariff of MERI. “We can’t do things that we could do in the 1970s and 1980s in the 21st century.”

Mr. Abdullah’s success in office could be harmed by the schizophrenic nature of the plan. On the one hand, the prime minister wants to build a Malaysia that is able to stand on its own feet and meet the challenges of a rising China. On the other hand, he is hanging on to some of the old—and politically popular—ways of protecting the bumiputras.

The Proof Is In the Implementation

EVEN IF THE tension between change and political inertia could be resolved—and this is unlikely given that abandoning affirmative action would invite political turmoil at

the grass-roots—there are a host of other challenges if the plan is to succeed. First, Mr. Abdullah needs to win people over to his vision. The prime minister seems popular and the tirades from Mr. Mahathir will probably serve him well. Malaysians seem to find the former prime minister’s antics tiresome. However, Mr. Abdullah will not be able to capitalize on the outbursts for long—sooner or later he will need to provide meaningful answers. As it stands, his administration will have to sell his ideas—a task made all the more difficult by the vague, touchy-feely bits in the plan.

Second, Mr. Abdullah needs to cement support from his party, UMNO, by addressing the issues raised by Mr. Mahathir and dispelling rumors that it’s only a matter of time before Mr. Abdullah is replaced. Third, the civil service has the potential to make or break any plan to overhaul the economy. With a shift to investment in people, many wonder if the government and its civil service will even know where to start. Anticipating such claims, a substantial part of the 9MP is devoted to addressing “public-service delivery” issues. But having a plan without the proper implementation processes in place would seem to be a classic case of putting the cart before the horse.

For Mr. Razak of MSRC, timing is of utmost importance. “If after one year of the 9MP there’s no change, then it’s time to do something drastic,” he says. But he is unsure that Mr. Abdullah can pull it off. “[Mr.] Abdullah is a product of the system,” he says. “I am not sure to what extent he can break the mold and think outside of the box.” ■



Singapore's 'Martyr,' Chee Soon Juan

by Hugo Restall



STRIDING INTO THE Chinese restaurant of Singapore's historic Fullerton Hotel, Chee Soon Juan hardly looks like a dangerous revolutionary. Casually dressed in a blue shirt with a gold pen clipped to the pocket, he could pass as just another mild-mannered, apolitical Singaporean. Smiling, he courteously apologizes for being late—even though it is only two minutes after the appointed time.

Nevertheless, according to prosecutors, this same man is not only a criminal, but a repeat offender. The opposition party leader has just come from a pre-trial conference at the courthouse, where he faces eight counts of speaking in public without a permit. He has already served numerous prison terms for this and other political offenses, including eight days in March for denying the independence of the judiciary. He expects to go to jail again later this year.

Mr. Chee does not seem too perturbed about this, but it drives Singaporean Prime Minister Lee Hsien Loong up the wall. Asked about his government's persecution of the opposition during a trip to New Zealand last month, Mr. Lee launched into a tirade of abuse against Mr. Chee. "He's a liar, he's a cheat, he's deceitful, he's confrontational, it's a destructive form of politics designed not to win elections in Singapore but to impress foreign supporters and make himself out to be a martyr," Mr. Lee ranted. "He's deliberately going against the rules because he says, 'I'm like Nelson Mandela and Mahatma Gandhi. I want to be a martyr.'"

Coming at the end of a trip in which the prime minister essentially got a free ride on human rights from his hosts—New Zealand Prime Minister Helen Clark didn't even raise the issue—this outburst showed a lack of self-control and acumen. Former

~ *Mr. Restall is editor of the REVIEW.*

Prime Minister Lee Kuan Yew, the man who many believe still runs Singapore and who is the current prime minister's father, has said much the same things about Mr. Chee—"a political gangster, a liar and a cheat"—but that was at home, and in the heat of an election campaign.

Mr. Chee smiles when it's suggested that he must be doing something right. "Every time he says something stupid like that, I think to myself, the worst thing to happen would be to be ignored. That would mean we're not making any headway," he agrees.

But one charge made by the government does stick: Mr. Chee is not terribly concerned about election results. Which is just as well, because his Singapore Democratic Party did not do very well in the May 6 polls. It would be foolish, he suggests, for an opposition party in Singapore to pin its hopes on gaining one, or perhaps two, seats in parliament. He is aiming for a much bigger goal: bringing down the city-state's one-party system of government. His weapon is a campaign of civil disobedience against laws designed to curtail democratic freedoms.

"You don't vote out a dictatorship," he says. "And basically that's what Singapore is, albeit a very sophisticated one. It's not possible for us to effect change just through the ballot box. They've got control of everything else around us." Instead what's needed is a coalition of civil society and political

society coming together and demanding change—a color revolution for Singapore.

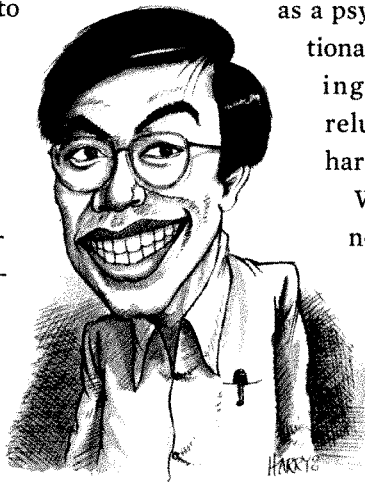
So far Mr. Chee doesn't seem to be getting much, if any traction. While many Singaporeans don't particularly like the PAP's arrogant style of government, the ruling party has succeeded in depoliticizing the population to the extent that anybody who presses them to take action to make a change is regarded with resentment. And in a climate of fear—Mr. Chee lost his job

as a psychology lecturer at the national university soon after entering opposition politics—a reluctance to get involved is hardly surprising.

Why is all this oppression necessary in a peaceful and prosperous country like Singapore where citizens otherwise enjoy so many freedoms? Mr. Chee has his own theory that the answer lies with strongman Lee Kuan Yew him-

self: "Why is he still so afraid? I honestly think that through the years he has accumulated enough skeletons in his closet that he knows that when he is gone, his son and the generations after him will have a price to pay. If we had parliamentary debates where the opposition could pry and ask questions, I think he is actually afraid of something like that."

That raises the question of whether Singapore deserves its reputation for squeaky-clean government. A scandal involving the country's biggest charity, the National Kidney Foundation, erupted in 2004 when it turned out that its Chief Ex-



ecutive T.T. Durai was not only drawing a \$357,000 annual salary, but the charity was paying for his first-class flights, maintenance on his Mercedes, and gold-plated fixtures in his private office bathroom.

The scandal was a gift for the opposition, which naturally raised questions about why the government didn't do a better job of supervising the highly secretive NKF, whose patron was the wife of former Prime Minister Goh Chok Tong (she called Mr. Durai's salary "peanuts"). But it had wider implications too. The government controls huge pools of public money in the Central Provident Fund and the Government of Singapore Investment Corp., both of which are highly nontransparent. It also controls spending on the public housing most Singaporeans live in, and openly uses the funds for refurbishing apartment blocks as a bribe for districts that vote for the ruling party. Singaporeans have no way of knowing whether officials are abusing their trust as Mr. Durai did.

It gets worse. Mr. Durai's abuses only came to light because he sued the Straits Times newspaper for libel over an article detailing some of his perks. Why was Mr. Durai so confident he could win a libel suit when the allegations against him were true? Because he had done it before. The NKF won a libel case in 1998 against defendants who alleged it had paid for first-class flights for Mr. Durai. This time, however, he was up against a major bulwark of the regime, Singapore Press Holdings; its lawyers uncovered the truth.

Singaporean officials have a remarkable record of success in winning libel suits against their critics. The question

then is, how many other libel suits have Singapore's great and good wrongly won, resulting in the cover-up of real misdeeds? And are libel suits deliberately used as a tool to suppress questioning voices?

The bottling up of dissent conceals pressures and prevents conflicts from being resolved. For instance, extreme sensitivity over the issue of race relations means that the persistence of discrimination is a taboo topic. Yet according to Mr. Chee it is a problem that should be debated so that it can be better resolved. "The harder they press now, the stronger will be the reaction when he's no longer around," he says of Lee Kuan Yew.

The paternalism of the PAP also rangles, especially since foreigners get more consideration than locals. The World Bank and International Monetary Fund will hold their annual meeting in Singapore this fall, and have been trying to convince the authorities to allow the usual demonstrations to take place. The likely result is that international NGO groups will be given a designated area to scream and shout. "So we have a situation here where locals don't have the right to protest in their own country, while foreigners are able to do that," Mr. Chee marvels. Likewise, Singaporeans can't organize freely into unions to negotiate wages; instead a National Wages Council sets salaries with input from the corporate sector, including foreign chambers of commerce.

All these tensions will erupt when strongman Lee Kuan Yew dies. Mr. Chee notes that the ruling party is so insecure that Singapore's founder has been unable to step back from front-line politics. The

How many libel suits have Singapore's great and good wrongly won, covering up real misdeeds?

PAP still needs the fear he inspires in order to keep the population in line. Power may have officially passed to his son, Lee Hsien Loong, but even supporters privately admit that the new prime minister doesn't inspire confidence.

During the election, Prime Minister Lee made what should have been a routine attack on multiparty democracy: "Suppose you had 10, 15, 20 opposition members in parliament. Instead of spending my time thinking what is the right policy for Singapore, I'm going to spend all my time thinking what's the right way to fix them, to buy my supporters votes, how can I solve this week's problem and forget about next year's challenges?" But of course the ominous phrases "buy votes" and "fix them" stuck out. That is the kind of mistake, Mr. Chee suggests, Lee Sr. would not make.

"He's got a kind of intelligence that would serve you very well when you put a problem in front of him," he says of the prime minister. "But when it comes to administration or political leadership, when you really need to be media savvy and motivate people, I think he is very lacking in that area. And his father senses it as well."

However, the elder Mr. Lee's death—he is now 82—is a necessary but not sufficient condition for change. Another big factor is how civil society is able to use new technologies to bypass PAP control over information and free speech. The government has tried to stifle political filmmaking, blogging and podcasting. *Singapore Rebel*, a 2004 film about Mr. Chee by independent

artist Martyn See, was banned but is widely available on the Internet.

Meanwhile, pressure for Singapore to remain competitive in the region has sparked debate about the government's dominant role in the economy. Can a top-down approach promote creativity and independent thinking? The need for transparency and accountability also means that Singapore will have to change. That is the source of Mr. Chee's optimism in the face of all his setbacks: "I realize that Singapore is not at that level yet. But we've got to start somewhere. And I'm prepared to see this out, in the sense that in the next five, 10, 15 years, time is on our side. We need to continue to organize and educate and encourage. And it will come."

He doesn't dwell on his personal tribulations, but mentions in passing selling his self-published books on the street. That is his primary source of income to feed his family, along with the occasional grant. As to the charge of wanting to be a martyr, once he started dissenting, he found it impossible to stop in good conscience. "The more you got involved, the more you found out what they're capable of, it steels you, so you say, 'No, I will not back down.' It makes you more determined."

Perhaps it's in his genes. One of Mr. Chee's daughters is old enough that she had to be told that her father was going to prison. She stood up before her class and announced, "My papa is in jail, but he didn't do anything wrong. People have just been unfair to him." ■



Taiwan's Crisis of Confidence

by Jonathan Adams



IN THE SHADOW of the world's tallest building, Taipei 101, a team of roller-skating models wheeled by in red wigs, white hot-pants and red sequin halter-tops—touting a new graphics card for computers. Inside five nearby convention halls in the upscale Xinyi district, some 30,000 foreign buyers babbled away in English, Mandarin, German and Urdu, while ogling the hi-tech world's latest gizmos: sports-car themed laptops, smart-phones and massive flat screen TVs. This was early June's Computex—a boisterous carnival for geeks that's on track to becoming the world's largest computer trade show, overtaking CEBIT in Hanover, Germany. Computex is proof positive that Taiwan's firms remain the vital heart of the global electronics manufacturing business, and that Taiwan has kept pace with the cutting edge of globalization.

And yet, despite the beaming models in

body-hugging vinyl and all the new gadgets, a gloom lurked beneath the surface of this year's show. In conversations with staff from a handful of Taiwan's top IT firms, an odd refrain emerged: the tech industry may be thriving, but Taiwan's broader economy is in trouble. The disconnect was all the more jarring when such comments came from people holding some of the island's best-paid jobs in its brightest sector. Said a PR representative from one of the island's top contract manufacturers: "You turn on the TV every day and see bad news about the government and about the economy. How can anyone be confident about Taiwan's future? I'm afraid [Taiwan] will keep declining."

What's going on here? Surely the economy isn't doing as badly as all the pessimism—or the island's sensationalized media reports—would suggest. In fact, in

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some respects the economy is doing quite well. Unemployment recently hit a five-year low of 3.78%; the island's exports surged to a record high in May (\$18.93 billion), led by strong demand for electronics. And Taiwan ranked an impressive fifth in the World Economic Forum's latest global competitiveness report, beating out other Asian rivals such as Singapore (6th) and Japan (12th).

To be sure, there are plenty of real economic challenges: household disposable income growth has stagnated; the island's manufacturing base has hollowed out; South Korea has emerged as a key competitor; and Beijing is working to marginalize Taiwan from the trend of Asian economic integration. But Taiwan's economy isn't doomed, and the island has the capacity to meet the challenges ahead. The best explanation for Taiwan's angst is more than just economic, it's psychological: What Taiwan is facing is a crisis in confidence.

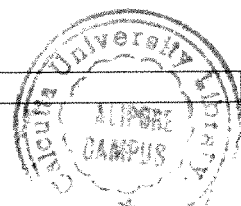
IT'S EASY TO be misled into thinking that the root of the problem is Taiwan's troubled relations with China. Chen Shui-bian's government is widely criticized for antagonizing Beijing and not moving fast enough on opening cross-Straits economic links—which the opposition says is stunting the island's development. Led by Kuomintang (KMT) chairman Ma Ying-jeou, Mr. Chen's opponents want to establish both direct air links and a raft of closer economic ties with China.

But Mr. Chen's Democratic Progressive Party (DPP) is wary of China, and wants to encourage businesspeople to diversify to

places like India. The government's fear is that overdependence on China will play into Beijing's long-term strategy, in which cross-Straits economic integration is the slippery slope that will lead to political unification. Moreover, they're concerned about eroding Taiwan's competitive edge by allowing its best technology to go to China. They've therefore prevented the island's firms from moving cutting-edge chipmaking technology to China, for example, and have kept in place a regulation capping Taiwanese firms' investment in China at 40% of their paid-in capital.

The public increasingly supports links as a way to help the economy: according to a Gallup poll conducted last year, nearly 70% support direct cross-Straits passenger flights (up from 50% just two years ago) and 62% support allowing more Chinese tourists to visit Taiwan. The island's voters are therefore inclined to reject economic isolationism—which means that the 2008 presidential election will likely be won by a KMT candidate who promises closer economic links (presumably Mr. Ma), or a DPP candidate who successfully co-opts that issue.

But if closer cross-Straits ties are inevitable, they are not a cure-all for Taiwan's economic woes. To be sure, direct flights would save businesses huge amounts of money and the hassle of having to travel to the mainland through Hong Kong or Macau. And an influx of Chinese tourists would provide a shot in the arm for the island's services and tourism sectors, which have struggled, while the tech firms in Hsinchu rake in revenues. Both measures would provide an undeniable psychological boost for the island.



However, the beneficial effects of direct links are too often exaggerated—and an overemphasis on what they can deliver distracts attention away from Taiwan's deeper, longer-term challenges. "I don't think [direct links] are the key factor that will help improve Taiwan's competitiveness," said Johnny Chiang of the Taiwan Institute of Economic Research (TIER). "The real economic problems still have to be solved by Taiwan itself."

TIER conducted a study last year that assumed the Association of Southeast Asian Nations, plus China, Japan and South Korea would form a free trade area and exclude Taiwan. Without direct links, it was estimated that Taiwan's GDP would drop by 0.0187%. But with direct links, the effect was only slightly blunted, to a 0.0135% drop. And analysts estimate the boost from Chinese tourism made possible by regular flights would only be about \$600 million, in what's currently a local \$12 billion industry.

In fact, many in Taiwan are less focused on China than on South Korea, which has emerged as a key competitor in an array of electronics and other exports. There's been much hair-pulling on the island over the fact that South Korea's per capita GDP last year surpassed Taiwan's. Anxiety was heightened in May when Deputy U.S. Trade Representative Karan Bhatia gave Taiwan the cold shoulder on negotiating a U.S.-Taiwan FTA—which the Chen administration dearly wants—and then jetted off to South Korea for FTA talks with Seoul.

Taiwan has attempted to seek greener pastures by inking FTAs with its handful

of Central American allies, including Panama and, most recently, Nicaragua. Such agreements are only marginally helpful. The solutions to Taiwan's economic problems won't be found far across the Pacific, but rather much closer to home.

The island's fundamental long-term challenge is how to manage the transition from export-led manufacturing to a services-based economy amid fierce, unprecedented competition brought on by globalization.

Duncan Wooldridge, a Hong Kong-based economist with the investment bank UBS, traces stagnant incomes to the previous decade, when Taiwan's small- and medium-sized manufacturers began getting squeezed. China's surging economy growth drove up commodity costs while overseas customers demanded lower prices, prompting Taiwan firms to shift productions offshore—mostly to China—hollowing out the island's manufacturing sector and forcing many unskilled workers into the lower-paid services sector.

That squeeze—what Wooldridge calls the "terms of trade shock"—combined with the collapse of the tech bubble in 2000 to deliver a one-two punch to the wallets of many Taiwanese. Inflation-adjusted household disposable income growth, which averaged more than 6% per year in the 1990s, dropped sharply to around 1% on average since 2000. Real wages so far this decade have been flat or in decline.

In response, the Taiwanese turned to credit to keep up their buying habits, which fueled a recent bubble. While Taiwan's problem was small compared to a

Taiwan is badly in need of leadership; this is where politicians have failed their people.

similar binge earlier this decade in South Korea, media coverage of suicides and crimes involving so-called *ka nu*, or card slaves, have fueled the popular perception of an economy gone off the rails.

But Mr. Wooldridge says the *ka nu* are just a symptom of Taiwan's broader challenge: how to create income growth that's not just limited to just a few lucky sectors. That challenge is shared by manufacturing-based economies that are struggling to move up the value chain amid fierce competition. And the solutions are those any economist would recommend. "I don't view what ails Taiwan's economy as being fundamentally driven by a China problem, because no one else in the region has been able to avoid these challenges," said Mr. Wooldridge. "The longer-term issue is fundamentally how to get household income back up, and that's going to require broad-based liberalization, a restructuring of the services sector and an effort to move up the ladder to higher value goods."

Businessmen in the high-tech industry are forging ahead on their own, by moving aggressively into branding to create a higher value-added model. And Taiwan is well-positioned to benefit in hot industries like LCD panels for new slim-screen TVs: the nation's scrappy firms last year overtook South Korea's as the top producer of flat panels.

But outside the tech sector, the Taiwanese are badly in need of leadership. And this is where Taiwan's politicians—both the government and the opposition—have

failed its people. What's missing is a broad, long-term vision for where the country is headed and how it will meet the tough economic challenges ahead. The lack of such a vision is probably the single best explanation for the deep unease felt by many Taiwanese about their economic future.

To be fair, the government has offered an array of plans. It initiated a "two trillion, two star" program of incentives to boost production in its leading high-tech sectors: semiconductors and flat panels. It is also bolstering emerging sectors that look promising: Deputy Minister of Economic Affairs Chen Ruey-long recently touted the government's efforts to jumpstart the energy conservation and renewable energies industries. And Mr. Chen has paid plenty of lip service to privatizing state-dominated industries and liberalizing the financial sector.

But these initiatives have not been tied together into an overarching vision that could give the public a sense of national purpose and direction. Moreover, Mr. Chen's government has been blasted for its amateurish approach to economic management, erratic policy-making, failure to consult and heed expert opinion, and inability to create a good investment environment. And many feel the government has moved too slowly on liberalizing of the financial sector, which is seen as crucial for making Taiwan's firms more competitive.

The problems can't all be laid at Mr. Chen's feet, however. Taiwan has been paralyzed by deep political gridlock. A

conference in 2001 was convened to achieve a consensus on economic direction, but many of its conclusions have yet to be implemented—and since then, relations between Mr. Chen's government and the opposition-controlled legislature have deteriorated into an all-out warfare. The opposition has pursued a scorched-earth policy that's rendered the government completely dysfunctional on a wide range of issues. And the opposition has also failed to articulate a comprehensive economic vision for Taiwan that goes beyond the mantra of direct flights with China.

In fact, the political gridlock has become so bad that many in Taiwan have taken a "plague-on-both-their-houses" attitude and begun to question whether their young democracy is capable of making the tough collective decisions needed in order to move forward. "Who in Taiwan has a blueprint for what Taiwan will look like tomorrow? What's the business plan? Why should I vote for any of these parties?" asks Pamir Law Group's managing partner Nicholas Chen.

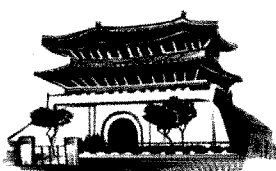
VINCENT SIEW BELIEVES he has the answer. Sitting in his sunny second floor-office in a leafy Taipei neighborhood, the former premier and economics minister lays out the broad outlines of a study to be submitted at a national economic conference scheduled for late July. Mr. Siew, now the chairman of the Chung Hua Institute for Economic Research, says that it's critical for the nation to map out a 10-year economic plan at the conference. "This conference must have a long term vision—and with that vision,

people's confidence could be restored," he said.

Mr. Siew's plan calls for both closer economic integration with China and an FTA with the U.S. But the centerpiece is an upgrade of Taiwan itself. The plan's highlights—what Mr. Siew calls "bridges, brains and branding,"—are echoed by others: Taiwan should aim to become a global service center by 2015, bring in more foreign talent, and innovate up the value chain. He points to European countries like the Netherlands, Finland and Ireland as models for Taiwan, and says the nation should develop a "small but beautiful" economic strategy to capitalize on the advantages of its nimble, small and medium-sized enterprises.

That all sounds great in theory. But there's cause to be skeptical. Will the nation's politicians be able to put aside their "gotcha" politics long enough to truly focus on the nation's economic future—particularly given the opposition's recent push to oust the president by any means? Some relief from the political logjam may come next year, when constitutional changes create a more stable two-party system in the legislature.

But to listen to Mr. Siew, Taiwan may not be able to afford to wait that long. "The day is coming when people will stand up and say, 'We won't let these irresponsible politicians play these games that hurt our economy and our livelihood,'" he said. Until the island's political leaders can put aside their squabbling and communicate a plan for the nation's economic future, the Taiwanese will be left to lurch ahead in the dark on their own—and that's not likely to bolster anyone's confidence. ■



Democracy Evolves In South Korea

by Balbina Y. Hwang



IN THE NATIONWIDE elections held in South Korea in late May, the main opposition Grand National Party achieved an overwhelming victory, signaling a strong public vote of no-confidence for President Roh Moo Hyun and his embattled Uri Party. This election was considered critical to the future of the Roh administration, as not only a public verdict on his embattled domestic policies, but all his controversial foreign-policy stances, including engagement of North Korea, challenge of traditional alliance relations with the United States, and antagonistic stance toward Japan.

Thus, the significance of the election defeat was not lost on the governments in Washington, Tokyo and Pyongyang. All three are experiencing uncertain relations with the Roh administration, so these foreign governments consider the outcome as an important political barometer for the

December 2007 presidential elections and the future leadership of South Korea. In addition, the GNP victory is viewed as a blow to Mr. Roh's determination to pursue full engagement of North Korea despite strong U.S. and Japanese skepticism, and could signal the possibility of improved relations with Washington and Tokyo.

The conservative GNP—which holds the majority of seats in the National Assembly—had been waiting for this opportunity to win back the popular mandate. It achieved an overwhelming victory by securing 12 of 16 provincial governorships and mayoral seats, including the mayoralship of Seoul—in many cases by a margin as large as two to one.

But any assumption that the GNP will get a mandate to make significant changes to existing national and foreign policies may be premature. Despite receiving a

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strong boost from the public, the burden of producing solid policy alternatives to the ruling Uri party has actually increased.

The Korean public has become increasingly dissatisfied with the Roh government on a diverse range of domestic policies, including questionable social reform measures such as revamping of the education system. Mr. Roh's efforts to overhaul the rigid system ended up producing counter-productive results that has angered parents, pupils and teachers alike.

National economic performance has also suffered during Roh's administration, with real GDP growth in 2005 slowing to 4%, down from the 5% recorded in 2004. Middle-class disgruntlement has also grown as a result of Mr. Roh's failure to curb rapidly increasing housing prices despite introduction of antispeculation measures. Overall, public dissatisfaction stems from the fact that Mr. Roh pledged to promote greater equity across Korean society, but his policies seem to have had the opposite effect, increasing the rich-poor divide.

On the foreign-policy front as well, there is widespread discontent with the Roh administration's policies that support reconciliation with North Korea despite lack of reciprocity, insistence on greater equality in relations with the U.S., and stances that have increased friction with Japan. While a substantial portion of the South Korean public prefers engagement over confrontation with North Korea, even the engagers are growing increasingly skeptical of policies that have seemingly produced little tangible results in altering North Korea's hostile attitudes. Similarly, in terms of relations with the U.S. and Ja-

pan, although the majority of South Koreans desire greater independence from these two countries, they are questioning the wisdom of doing so at the cost of damaging critical relationships.

The defeat of Uri is in some ways an opportunity for the party to regroup and regain credibility before the December 2007 presidential race and national elections in April 2008. In the process, however, infighting both within the party and with the opposition is likely to become nastier, which will only serve to further polarize the political process.

And while it may be tempting for Mr. Roh's critics to view these election results as a rejection of the president's leadership, particularly in the foreign-policy arena, in reality there is likely to be little change in Seoul's orientation either toward North Korea or the United States. This is due to the Blue House's increasing isolation from the rest of the administration, as well as Roh's determination to pursue policies even without a clear public mandate. The failure of a previous impeachment effort has essentially given him free rein for the duration of his term. This is also an indication that despite the fact that a vibrant democratic process has taken root in South Korea, vestiges of an "imperial presidency" remain strong in the political culture. This is particularly evident in South Korea's foreign-policy stances.

In the U.S., the shock of Sept. 11 brought geopolitical concerns into the consciousness of voters, but in Korea these have always been an integral part of every citizen's life. In part this is due to the realities of having survived a fratricidal war that

For South Korea, the threat from the North stems not from Pyongyang's strength, but from its weakness.

killed more than one million Koreans a half century ago. The possibility of that conflict being reignited at a moment's notice is a very palpable and real threat, given the tenuous armistice agreement.

But on a deeper level, Koreans' internalization of developments outside their border predates the tragic division of the peninsula, and is a function of geopolitical realities. As a relatively small power sandwiched amidst great regional powers for centuries—the “shrimp among whales”—Korea's fate has more often than not been dictated by foreign influences. Thus, it is only natural that Koreans tend to think of Korean national interests in the context of peninsular implications, and then regional developments. Only after that do they think about the global context.

However, in the U.S. strategic thinking tends to follow the opposite course. Americans tend to first think about national interests in relation to the global environment. Then the focus narrows to the regional context, such as Northeast Asia, and only then onto the specific, such as peninsular matters. This is also natural, given America's position in the world and its relative power.

For the last half century, while the U.S.-R.O.K. security alliance prevailed as the primary deterrent to the North Korean threat, the pairing of such skewed strategic views posed few problems. In fact, it was the basis for an efficient division of labor between the two allies. However, as South Korea's relative position on the peninsula,

the region and the globe has dramatically changed, so too have the expectations of its people and government.

Despite the ongoing menace of North Korea's military threat, South Korea's dominance over the North, according to all economic and social standards, is undeniable: As the world's tenth largest economy, the R.O.K. dwarfs the North; its population is 44 million compared to the North's 22 million; its GDP per capita of over \$15,000 is far ahead of the North's \$250. South Korea is considered one of the most globalized countries in the world with an economy dependent on international trade, while the North is one of the most closed societies.

By all accounts, the strength of the U.S.-R.O.K. alliance for the last 50 years has allowed the South to prevail in its competition for survival against the North. Yet the alliance is deeply troubled, and its future existence is at a crossroads. One of the primary reasons is precisely the fundamental difference in strategic preferences between South Korea and the U.S.

South Koreans see confrontation with the North as something to be avoided at almost any cost—lest it destroy their hard-won prosperity and freedom. Thus from the South's perspective, the only way to address the North Korean threat is to coax the regime out of isolation and ease its transition into the international community. In the U.S., this type of engagement is criticized as naïve at best, and appeasement at worst.

This diametrically opposed view of North Korean threat stems from conflicting perceptions about its source. For the U.S., the "threat" emanates from the traditional sources of the regime's strength, a view that has remained unwavering since the Korean War: its continuation of a military-first policy, including the diversion of scarce national resources into maintaining its million man army; its aggressive missile and nuclear programs; its illicit activities, including counterfeiting; and even its human-rights abuses, which are all signs of the regime's power.

But for South Korea, the "North Korean threat" today emanates not from that regime's strength but rather its weakness: the failure of the economy, the instability of Kim Jong Il's rule and the fragile social conditions. Even illicit activities are considered desperate acts undertaken by a regime struggling to survive. Thus, the real threat posed by North Korea is that the inherently weak system might precipitously collapse, either through an implosion or an explosion that would unleash exorbitant costs on the South. As such, the policy implications are clear: For South Korea, engagement may be unpalatable but it is the only choice, while for the U.S. North Korea's continued threat must be contained.

Arguably, the basis of any alliance is the shared conception of common threats, as had been the basis of the formation of the U.S.-R.O.K. alliance a half-century ago. Today, the threat remains, although the nature of that threat has dramatically changed. Nevertheless, there is no reason that the two countries cannot remain allies, nor does it mean that a common policy can-

not be forged.

However, the challenges of doing so have dramatically increased as a function of South Korea's democratization. Ironically, as South Korea has become "freer," the diversity of views over controversial issues such as how to resolve North Korea's nuclear threat has grown. The opportunities to voice opposition have also expanded, allowing for pro-North Korean views to be legitimized. The ultimate paradox of the South Korea's democratization may be that it has benefited the tyrannical North Korean regime.

Despite the seemingly clear results of the Korean elections, it remains unclear whether the Roh Moo Hyun government and the Uri party will alter domestic or foreign policies. Only days after the election, President Roh stated that he would "do [his] best to faithfully carry out the policies the government has started."

The cacophony of clashing opinions and public debate may be a positive development for the South, but the irony is that such freedoms, encouraged and supported by the U.S. for the last half-century, have actually allowed the two Koreas to draw closer together, creating increased Korean resentment of perceived U.S. interference in inter-Korean affairs. Thus, the challenge will be for both South Korean and American political leaders to encourage responsible outcomes that serve the interests not just of Korea but the entire region. Ultimately, the U.S and South Korea share fundamental goals on the Peninsula: the promotion of peaceful reconciliation between the two Koreas that contributes to stability and growth. ■



China Learns Education Lessons

EVERY YEAR CHINA'S schools churn out millions of "stuffed ducks"—graduates lacking in creativity and problem-solving skills. Yet if China hopes to make up for its brain deficit by wooing overseas-educated Chinese, then it is in for an unpleasant surprise. The REVIEW explores two of China's most pressing human-capital challenges.

Is China a Magnet For Global Talent?

by David Zweig

OVER THE PAST 30 years, the China region has been a great source of human talent to the western world. Much of this supply was drawn from Hong Kong as its residents sought to hedge against the political uncertainties of a 1997 handover. But as the former colony's recession to Chinese sovereignty transpired smoothly, the Hong Kong diaspora began returning to the region.

In mainland China, a similar "brain re-

gain" is currently underway: in 2005, the number of repatriates reached 30,000, up from 7,000 in 1999. Is the heyday of extracting human capital from Greater China over? Is China now a magnet for expatriate human capital, attracting talent that previously stayed overseas?

The Chinese government hopes so. It has been actively encouraging—at national, provincial, and municipal levels—the return of overseas scholars to China, cultivating a favorable political climate and culture for repatriating scholars, providing funding to attract returnees.

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The Chinese Academy of Sciences now regularly awards fellowships of 2 million yuan (\$250,000), 20% of which may go directly towards recipient salaries. Other common benefits include full-tenureship, housing, modern laboratories and equipment, and research teams comprised of (often homegrown) graduate students and research staff. Another program, the Ministry of Education's "Financial Support for Outstanding Young Professors," awarded 2,218 returning professors a total of 144 million yuan between the late 1980s and 2003. And the Cheung Kong Scholars Program, funded by Hong Kong billionaire Li Ka-shing, brought home 537 scholars from overseas, between 1998 and 2004, to become leaders in key research fields.

Local governments, too, compete amongst themselves for returning overseas talent. Cities offer myriad incentives to become the preferred destination, including housing discounts, office or factory floor space, jobs for spouses, international schools for children, and residence permits allowing for the retention of foreign citizenship status. Most large cities and county towns will also have specially designated zones for overseas scholars to establish businesses and receive assistance in navigating government bureaucracies. Beijing and Shanghai each have 14 such zones.

But surveys of scientists from four cities—Wuhan, Kunming, Guangzhou and Changsha—have shown that only a few repatriated scholars cite these recruitment efforts as a key reason for returning to China. More important, according to the surveys, were good government policies and political stability. In the summer of 2004,

we interviewed 100 repatriated entrepreneurs in Beijing, Shanghai and Guangzhou. Many believed that introducing new technology to China—even if it is not cutting-edge by global standards—can reap rich profits in the mainland. It seems that the rewards in China's domestic market, rather than government policy, have been the key attraction. Clearly, this is a powerful force in the reverse brain drain. This suggests that the government's impact has been indirect at best.

What about the quality of the returnees? Has China been successful in attracting the return of its best and brightest? Data do not tend to support this hypothesis. Rather, the theory is that those returning to China tend to have first been unsuccessful overseas. The Director of a CAS research institute in Northeast China has said that while the people he attracts usually fall into the top 50% to 80% of overseas scholars, the top 20% still remain abroad. Rao Yi, a neurologist at Northwestern University in Illinois claims that, in terms of international reputation and prestige, few returning scholars are of comparable quality to those who stay abroad. He believes that there are between 800 to 1,000 scientists of Chinese origin running independent labs in the U.S., and that these people are unlikely to return.

Our findings tend to support Mr. Rao's observations. In fact, surveys have shown that only a few scholars returning to China had to sacrifice high salaries or stable, tenured positions, and even fewer were returning with patents for innovative research. What's more, getting the very talented to return is just the first step; getting

Data suggests that those returning to China tend to have first been unsuccessful overseas.

them to stay is another matter altogether.

So how to account for the number of returning graduates? According to government officials, 50% of the 30,000 returnees in 2005 only completed an undergraduate or one-year master's degree, usually in Britain. With few prospects and little training for jobs, these relatively unskilled graduates then have no choice but to return to China. Contrary to popular belief, these are not the cutting-edge scientists, scholars or entrepreneurs that will propel China to the fore of the global economy. At best they can fill middle-level positions in the administrative hierarchy, or entry-level jobs in the commercial sector. Pejoratively called "seaweed" or *hai dai* (in contrast to *hai gui*, or "sea turtles," which habitually return to their birthplace but are of higher quality and value) by jealous people who had not gone overseas, these repatriates are as much a burden as a benefit to the Chinese state.

So why is the government so concerned about this situation? Preliminary research suggests that many unemployed returnees are children of recently retired government officials who invested their life savings in their only child. Many of these returnees are in their late twenties, their parents approaching retirement. But instead of bringing their parents security, these children face great difficulties even in finding lower paying jobs. In my own discussions with Chinese officials, I point out that this problem is the result of a market failure, not of government policy, and

that the market will adjust by discouraging young people from continuing to take this route. But local and central officials remain unconvinced.

Recruitment efforts by personnel bureaus in many municipalities have been unsuccessful. Encouraging entrepreneurial ventures have likewise been fruitless, given the dearth of entrepreneurial skills.

Much official anger is targeted at the United Kingdom, which treats Chinese youths as a source of foreign exchange for low quality British universities, but then abandons them upon graduation, forcing them to return to China with little professional training. This is contrasted to the situation in Canada, where a large contingent of Chinese doctorate graduates with professional experience is experiencing a glass ceiling and culture clash, together making China seem attractive again.

Clearly China's government has successfully created an environment attractive to repatriation. As the number of self-paying students increases, a certain percent will inevitably also have to come back. Moreover, according to a recent report by McKinsey, China is facing a shortfall in high-quality engineers, opening real opportunities for those who have studied abroad.

But as the discussion of *hai dai* shows, do not be persuaded by numbers alone; China appears to be entering a new period where increased flows of overseas students and returnees will bring with them new problems for China.

China's New Education System

by Benjamin Robertson

A PITHY SLOGAN that may well come to define Premier Wen Jiabao's first term in office, "Building a Socialist Countryside" promises, among other things, much in the way of support for the beleaguered basic education system. Prohibitively expensive and currently in the middle of a sensitive but much-needed curriculum overhaul, the proposed details of Mr. Wen's reform package bode well for the next generation of schoolchildren. The central government now needs to ensure the reforms can gain wider acceptance and implementation.

Under Mao, schools were limited in resources but fees were artificially low and financial aid was given to the poorest students. Deng Xiaoping changed all that. In the 1980s, the budgets of local governments were reprioritized as part of a drive to build infrastructure and attract investment, and new cutbacks placed the onus on school administrations to make up the difference. The result was basic education becoming slowly stratified. As top urban schools hiked annual fees and attracted leading talent and resources, poorer rural schools effectively stagnated. Access to quality basic education became a postcode lottery.

~ Mr. Robertson is a free-lance writer based in Beijing.

"The commercialization of education under Deng Xiaoping was a great mistake. The input structure became a pyramid when really the pyramid should have been inverted," says Li Chenggui, a rural education expert at the Chinese Academy of Social Sciences (CASS). China, he says, has created a "dual track system."

The results are clear to see. Today China is the world's fourth largest economy but ranks among the lowest in terms of investment in education. According to World Bank figures, in 2000 China spent 2.1% of GDP on education, putting it on par with Chad. Per capita investment was less than half that of South American countries, and only 9% of OECD countries.

In a 2005 survey of 4,128 mostly urban adults by the China-based Horizon Research Consultancy Group, the cost of their child's education was for the first time listed as the number one household expense. These families sought to give their single child the best start possible in an increasingly competitive marketplace. Among rural households, where average annual incomes are now 3,250 yuan (\$402) per capita, 32.6% of annual expenditure was devoted to education. In urban areas, it was between 23% and 26%. Of those questioned, 40% to 50% blamed the cost of education for a reduced standard of living.

It is an expense that sometimes has tragic consequences. In July of last year, the Chinese media reported that a 13-year-old girl from Ningxia Province had killed herself rather than see her parents spend the necessary 100,000 yuan to secure her a place in a leading school. The story prompted a short period of national soul

In 2000, China spent 2.1% of its GDP on education, putting it on par with Chad.

searching, but the fundamentals behind what is essentially a closet privatization have not changed. In fact, though parents and officials often rail against the lack of transparency in these fees, the government has begun taxing—and thus legitimizing—them.

The issue of fees “is not driven by anyone’s vision of what constitutes a good education. When schools operate as businesses, they make business decisions,” said Nick Young, founding editor of the Beijing-based China Development Brief, a monthly publication that covers social development and civil society issues. In addition to the one-off “golden handshake” charged by schools with reputations for getting children into good universities, additional miscellaneous fees are charged annually including those that cover extra classes, books, uniforms, and even water, photocopying and administration. Annual charges can range from several hundred to several thousand yuan a year. In some cases, like those involving migrant workers who have to pay extra registration fees because they lack city-specific *hukou* (residence permits), parents have deemed the costs so exorbitant that they simply open their own schools and hire unqualified teachers instead.

According to government figures, 1% to 7% of children go without an education in China, though some people interviewed talked of figures as high as 40% in deprived areas.

In the northern Beijing suburb of Changping, the “Village of Sun” charity, of-

fering refuge for 250 children of prison inmates, is a beacon of light for these otherwise unfortunate lives. Founding the first village in 1996 in Shanxi Province, where she worked in the prison service, headmistress Zhang Shuping fills the vacuum between a haphazard retreat of the state and a growing but still nascent civil society. With no parents and wider family to support them, and socially shunned for being the offspring of convicts, the children who end up in her care would otherwise be walking the streets, Ms. Zhang says.

While the Beijing city government opens state-of-the-art schools that would be the envy of the developed world, Ms. Zhang’s children survive off donations from international companies and state-run charities. Benefiting from rent-free land courtesy of the local Changping county government, Ms. Zhang has had to broker a deal with a nearby school to accept those in her charge. Registration fees have been waived as a favor, but Ms. Zhang still needs to pay 600 yuan and 1,000 yuan a year for primary and junior secondary school, respectively. So long as she can raise one million yuan annually to cover expenses, these children may have a chance at a future that would otherwise be denied to them.

The good news is that the central government is now joining the effort. Partly because of mounting concerns over what the gaping divide in income and living standards between town and country could mean for social stability, Premier

Wen has led calls for prioritizing education spending.

Announcing plans to spend an additional 218 billion yuan over the next five years, Beijing says the money will cover an overhaul of the rural education sector. Called the "Two Exemptions and One Subsidy" policy, it includes guaranteed salary payments to teachers and offers to cover education fees for impoverished families by 2007. The government says it will save the average rural family around 160 yuan a year, complimenting similar savings made by the abolition of agricultural taxes at the start of the year. Over the next five years, said officials at March's National People's Congress, education spending should reach 4% of GDP.

A worthy start, the money will help address the investment imbalance that currently exists. There are four times more primary and secondary schools in the countryside, says Mr. Li of CASS, yet rural China receives only 38% of total basic education funding.

In discussing plans for subsidized education, state media talk about how government spending will be gradually expanded over time to include all rural households and possibly urban ones as well. If completed, it would shift much of the burden of education onto the state, though it remains to be seen how much will be left for cash-strapped local governments to cover. That, however, is at least 10 to 15 years in the future. At a UNESCO conference last November in Beijing, during which Premier Wen announced the move, he also solicited the help of the developed world in reaching this goal. It was not clear how

much China hopes to raise from overseas—and given the sizeable figures involved it is unlikely any one country could make any real difference—but to reinforce the point that he is a giver as well as a taker, Mr. Wen offered a \$1 million donation to UNESCO for use in Africa.

At the same time, as the central government starts handing out funds, a comparatively hushed but no less important debate is being discussed over the national curriculum. Since the late 1990s, increasingly vocal voices have argued that China's traditional pedagogy is failing its children. Historically based on rote learning, China's schools are known for their ability to churn out children who excel at memorization and passing exams—so-called 'stuffed ducks'—but who lack the creativity and basic problem solving and communication skills that are now so essential in a global community. Since last year, these reformers have been given the chance to prove themselves. A new curriculum has just been adopted nationwide following several years of pilot trials.

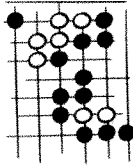
Called a "quality-oriented education" in Chinese education parlance, its supporters make no bones about its borrowing from Western pedagogy. Describing it as "a counterreaction to the exam-focused methodology of before," Beijing University education specialist Chen Xiangming explains that the new curriculum emphasizes group interaction in the classroom, coursework evaluation and, above all, a focus on personal enjoyment. "With the old system children disliked class because of its regimented structure and intense pressure levels," says Ms. Chen. Some surveys

among school age children even suggest large numbers have considered suicide.

The new curriculum however, is aimed at more than making school fun. One of the complaints of the traditional teaching system was that it was geared towards the *gaokao*, a series of final exams that decided which university a student could attend. No matter that less than 20% of Chinese children go on to university—that was the road that everybody had to take, and that every child and parent dreamed of completing. “The *gaokao* is like a very long apprenticeship. If you drop out half way you are left with very limited skills,” says Development Brief’s Mr. Young. While the *gaokao* still exists, by introducing more practical skills at an early age education gurus are hoping that children will at least leave school with not only a knowledge of

Chinese and arithmetic, but also the know how to analyze and solve problems.

The adoption of the new system has not gone smoothly. While parents praise its idealism, in the highly competitive world of Chinese education some have expressed concern that time spent in “free study” periods and physical exercise is time wasted. Also, in the rush to get the curriculum adopted, little effort was spent on the necessary teacher training. Old habits die hard, and asking teachers to place themselves in the middle rather than at the top of a classroom’s hierarchy is proving too much for many. Despite the hang-ups, Mr. Chen remains optimistic. “In the United Kingdom I was told it took a country of 60 million 20 years to adopt the modern teaching style. In China I can only suppose it will take much longer.” ■



China's Thirst for Middle Managers

by Wang Jianmao



CHINA'S AMBITIOUS plan for the development of its science and technology program aims to raise its R&D-to-GDP ratio from 1.3% in 2005 to 2.5% in 2020, exceeding the current OECD average of 2.3%. Assuming a modest average growth of 7% in GDP, this would imply R&D spending of RMB 1.25 trillion (\$156 billion) by 2020.

Translating this huge increase in investment into bona fide innovation and intellectual property, however, will require more than just state-of-the-art laboratories and researchers; there also needs to be the right management expertise to guide the process. Currently there is a shortage of world-class MBA training programs in China. But the process has already come a long way over the past 20 years.

In the early 1990s when Deng Xiaoping decided to establish a socialist market economic system, the first batch of MBA licenses were granted to nine state-owned

universities. However, these schools had difficulty producing graduates qualified for mid-level positions in foreign-invested enterprises. In addition to teaching in Chinese with a teacher-centered curriculum, they were also part time and profit oriented. As China's FDI inflow exploded from \$4.4 billion in 1991 to \$11 billion in 1992 and \$27.5 billion in 1993, the need to improve on China's pool of "international MBA" graduates became obvious.

But simply expanding and upgrading state-owned business schools was not going to be enough to meet this exploding demand. Rather, what was needed were cooperative alliances similar to the country's joint ventures and cooperative enterprises in industry.

Based on a pilot project to introduce MBA education into China, the China Europe International Business School (CEIBS)

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was established in 1994 as a joint venture institution between the Shanghai Municipal Government and the European Commission. As a "special education zone," CEIBS was granted full autonomy to design programs according to best practices overseas, recruit professors from world-class institutions across Asia, Europe and the U.S., admit students through its own admission exam and issue its own degree certificates. Less than 12 years later, CEIBS is offering the largest full-time international MBA program in China and the largest EMBA program in the world. The two programs are respectively ranked 21st and 13th globally by the Financial Times.

Tsinghua University in Beijing and Fudan University in Shanghai followed in 1996 with the establishment of their international MBA (IMBA) programs in cooperation with MIT's Sloan School of Management. The curricula of the programs were jointly developed by the American and Chinese partners, following the model of Sloan MBA. Every year, Sloan receives Chinese faculty members for training and sends a few professors to China to conduct workshops for Chinese faculty as well as co-teach classes with their Chinese colleagues. The Lingnan College of Sun Yat-sen University in Guangzhou entered into a similar partnership with Sloan in 1999. All these Chinese-foreign cooperative MBA programs admit students through the same admission exam and issue the same degree certificates designed by the Academic Degree Committee of the State Council as their wholly state-owned counterparts.

In 1998, Beijing International MBA (BiMBA) was created as a joint venture between

the China Center for Economic Research of Peking University and a consortium of 26 U.S. business schools of headed by Fordham University. The faculty of BiMBA is a combination of full-time CCER employees and visiting professors of the U.S. schools. All courses are taught in English, and graduates receive MBA degree certificates from Fordham University, a standard practice for all Chinese-foreign joint-venture MBA programs with the exception of CEIBS.

Currently, there are several dozen joint-venture MBA programs in China approved by the education authorities in which partnering institutions share curriculum and faculty. Nevertheless, an overwhelming majority of these are some discounted version of a second-, third- or even fourth-tier foreign program. In fact, none of the top 30 business schools in the Financial Times' global MBA ranking has any joint-venture program in China, thanks to China's insistence that foreign universities may only teach in the country under the auspices of a joint venture. Concerned that part-time, profit-oriented local partners may damage their image, first-tier U.S. and European business schools have chosen to stay away.

By the beginning of the century, all first-tier state-owned business schools in China had established their international MBA programs. At their inception, however, almost all of these were part-time. But organizers soon realized that they needed to go at least partially full-time in order to take advantage of their English-language curriculum. A full-time schedule would allow them to increase the diversity of their student body by accepting students

from other parts of the world and to exchange students with foreign business schools with less difficulty.

A full-time schedule would also give their students enough time to digest course content, to attend fora by corporate CEOs and to share experience and forge team spirit and friendships amongst themselves. None of this would be possible for a part-time MBA student in China, as a recent survey of 705 multinational corporations in China revealed. The study, conducted by Hudson, a leading recruiting agency, indicated that 42% of their employees work more than 50 hours per week. Most of them give the same reason for working overtime as for choosing a part-time program: They are afraid of losing their jobs in a very competitive job market. Since a profit-oriented program usually cannot afford to eliminate nonperforming students, and a part-time program usually cannot ensure that students have the time to perform, a profit-oriented, part-time program is more likely to produce low-quality graduates.

To address the need for a full-time program, and to emphasize the importance of practical work experience, the State Economic and Trade Commission and the Academic Degree Committee of the State Council created a new track of MBA in 1997. The new track shares the same curriculum as the existing one, but rather than the traditional fall enrollment after a spring examination, the new track enrolls students in the spring, after an admission exam in fall of the previous year. Because of this difference in the enrolment season, the new track is commonly referred to as "spring MBA" while the existing track as

"fall MBA." The two tracks also differ in some minor aspects: The spring MBA remains a part-time program requiring five years' work experience and four years' university education; the fall mba can be either part- or full-time, and students need only as little as three years' experience, depending on education level. Tuition for the spring program is also 10% to 20% lower than the fall's. Every state-owned MBA school offers both tracks, with the spring program ranging in size from 57% to 94% of the fall enrollment levels.

In 2002, the Ministry of Education granted EMBA licenses to 30 state-owned MBA schools. These schools were allowed to charge 200,000 yuan (\$25,000) or even higher for an EMBA degree, several times as much as that of an MBA degree, on condition that 30% of the EMBA courses be taught by those faculty members who have taught EMBA overseas, 50% be taught by those with a doctorate degree and 80% be taught by those with business experience.

In the long term, the introduction of EMBA programs might help these state-owned business schools upgrade their faculties and allow them to use the profits of EMBA programs to subsidize MBA programs. In fact, a subsidized MBA program is a necessary condition for a brand business school no matter what the source of the subsidy is. In the short term, however, the introduction of EMBA programs took the best of their faculty members away from MBA programs. Around that time, graduates from low-quality MBA programs, whether state-owned or joint venture, started to flood the market, arousing outcries from corporate recruiters and media. After the government

Foreign schools are concerned that part-time, profit-oriented local partners may damage their image.

granted 27 new MBA licenses to raise the number of state-owned MBA schools to 88 in 2003, the "MBA bubble" in China burst.

There were alarming signs of a qualitative nature as well: the proportion of "fall MBA" exam-takers with junior college education had been rising while the average age of exam-takers had been falling. However, oversupply only happened in the low-end MBA market. In the high-end market, undersupply has persisted due to a shortage of high-caliber professors.

To address this shortage, some Chinese business schools aspiring to be world-class have been making great efforts, and there are outsiders able and willing to help. Harvard Business School introduced the Program on Case Method and Participant-Centered Learning to provide guidance and support regarding best practices in management education. The program focuses, in particular, on the case-study method of instruction and the participant-centered learning model. In 2005 and 2006, faculty members of 13 business schools in mainland China participated in PCMPCL on the campus of the Harvard Business School in Boston.

Facing insufficient supply of quality MBA education in China, many young Chinese have chosen to earn an MBA degree overseas, mostly in English-speaking countries. It was estimated that about one third of the 106,500 Chinese who left China in 2005 to study overseas at their own expenses were majors in business and related subjects. In fact, China has been outsourc-

ing most of its full-time international MBA education.

According to a report by China's biggest daily newspaper Cankao Xiaoxi, Keele University of the United Kingdom is planning to enroll 100 Chinese students into its MBA program every year. Kevin McCarthy, Director of London Higher, which represents London's universities and colleges, says that more than 40% of 40,000 Chinese students currently enrolled in British universities are majoring in management, business, economics or finance. Business studies accounts for an even larger proportion in Chinese returning from overseas study than in those leaving for overseas study. At a reception for applicants and alumni held by the U.K.'s Bath University at the Hilton Hotel in Shanghai this April, more than 80% of the alumni that showed up were from the school of management.

However, for those aiming at a future business career in China, studying abroad is never a perfect substitute for a world-class MBA education in China, not only because the focus of any MBA program overseas is unlikely to be business in China, but also because few foreign business schools can extend their marketing activities and career services to China. Which is why people with MBA degrees earned from second-tier or below overseas schools have started to experience the frustration that they cannot compete with graduates from the best full-time international MBA programs in China. Although a few business schools in the U.S. and Canada had

plans to launch a "China track" MBA, all but one of them have dropped such a plan because they do not have enough faculty members with the appropriate expertise and cannot find a Chinese partner able to provide such professors.

In total, "fall MBA" programs (including Chinese-foreign cooperative MBA programs), "spring MBA" programs, Chinese-foreign joint-venture MBA programs and others in China are enrolling approximately 25,000 students a year, close to the combined annual MBA enrolment of all Western European countries. However, China still lags significantly behind Western Europe in the existing stock of MBA degree holders and the average quality of MBA education, not to mention those of the U.S. Only about 5% of MBA students in China are enrolled in full-time programs while the proportion in the U.S. is more than half. Various studies suggest that there is a huge gap between demand and supply of qualified managers, especially those with crosscultural competency—the most sought-after for the China operations of multinational corporations and emerging Chinese global competitors. The fact that most international MBA programs in China have been reporting double-digit growth in average starting salaries of their graduates is the best evidence.

If China wants to succeed in its new en-

deavor to sustain high growth by switching the mode of growth, to enjoy the full benefits of its WTO membership by expanding trade and investment, and to develop its huge pool of raw talent, it will have to do many things, including expanding and, more importantly, upgrading its management education.

Many things can be done to augment China's capacity of producing world-class managerial talent, including the establishment of more "special education zones" and MIT-type partnerships between first-rate foreign schools and the best schools in China. It can also allow foreign partners to have more control in joint-venture programs, or even allow world-class foreign business schools to have wholly-owned operations in China—something similar to INSEAD in Singapore. If MIT can have partnerships with Chinese schools in coastal regions, then schools in coastal China can have similar partnerships with schools in inland China.

China needs a great number of quality professional managers at all levels—"horses that cover a thousand *li* a day"—for its huge and fast-growing market economy. However, China needs to reform its semiplanned business education and invest more in order to develop this resource in sufficient quantity and quality. ■



Thais Pay the Price For Political Turmoil

by Pichit Likitkijsomboon

ON ONE LEVEL, the recent impasse in Thai politics can be seen as a conflict between the government of Prime Minister Thaksin Shinawatra and the anti-Thaksin coalition led by the People's Alliance for Democracy, supported by parts of the urban middle class. However, beneath the surface, the conflict is really a struggle between the Thaksin government's policy of pushing Thailand toward a globalized and competitive capitalist economy on the one hand, and antiglobalization forces on the other.

Prime Minister Thaksin's globalization policies include the negotiations and conclusion of free trade agreements with the world's largest economies, such as Australia, China, India, Japan and the United States; the corporatization of state enterprises; bureaucratic reform; educational reform; and economic restructuring. Although implementation of these policies

has not been flawless, the direction is clear: a social and economic restructuring of Thailand to enable it to compete internationally.

Mr. Thaksin's strongest political base is his popularity among the urban and rural lower class throughout the country. His government is the first administration in modern Thai history that has provided real gains to these urban and rural poor through various allegedly "populist," redistributive measures. Unlike the urban middle class, whose complaints will be carefully heeded by any government, the urban and rural poor have little direct political influence at the national level. Their only advantage is number, as they are comprised of tens of million of people throughout the country. And the only political system which allows them to influence politicians to some extent

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INVESTORS' ANGST

Political instability in Thailand is affecting investor confidence

	2005 Jan-May	2006 Jan-May	Change (%)
Number of projects	465	521	12.0
Total investment (billion of baht)	346.6	128.6	-62.9

SOURCE: BOARD OF INVESTMENT, THAILAND

is democracy, with the rule of "one person one vote" regardless of income and education levels. The poor people have been looked down upon by the urban educated class who see them as selling their votes to corrupt politicians. The poor know very little about globalization, but the gains from the Thaksin administration have been sufficient to convince them of the prime minister's merit over other politicians. These are the facts which the urban middle class—with high incomes, life security, social status, easy access to credit and capital, and all the modern conveniences—finds hard to understand.

Mr. Thaksin's globalization policy and "pro-poor" measures have aroused anger and hatred among diverse groups of opposition which include some quarters of the urban middle class, conservative intelligentsia and university lecturers, old business interest groups and cartels, dinosaur politicians, most of Thailand's print media, and antitrade NGOs. Some of these, such as old business families and cartels, are losing out under Mr. Thaksin's pro-trade liberalization policy, while others are simply ideologically against capitalism and globalization—either from the right, such as the ultranationalist groups and moralist conservative intelligentsia, or from the left, such as antitrade NGOs, former leftist activ-

ists and academics with their rejection of electoral politics.

This assortment of opposition groupings knew they could never beat Mr. Thaksin and the urban-rural lower class at the ballot box. So their early strategy was to boycott the April 2 election, demanding Mr. Thaksin's immediate resignation and petitioning the king to appoint a "royal prime minister," which was equivalent to suppressing all legal and democratic processes and tearing up the Constitution. In essence, they were calling for a replacement of a democratically elected government by a "royally appointed" one, to be followed by an amendment of the Constitution to prevent Mr. Thaksin from returning to power. Their aim was not popular democracy, under which they would be outnumbered by the poor, but a constitution which guarantees weak political parties and weak government and, hence, a stronger political voice to the urban middle class and the intelligentsia. The motives of the PAD and its middle class-intelligentsia supporters are undemocratic and reactionary.

The king finally rejected the PAD's petition while the Constitutional Court ruled that the election—in which Mr. Thaksin's Thai Rak Thai party won 16 million out of a total of 28 million votes—was invalid and called for a fresh round of elections. However, it is clear that the TRT will win again in the new general election. So the PAD and its supporters have shifted their target to the Election Commission, accusing it of being biased in favor of TRT. They demand all commission members resign immediately and a new Election Commission be constituted by the Senate. The situation becomes

NOT A PRETTY PICTURE

*Economists concur that political instability
will affect the Thai economy in 2006*

	Old forecast	New forecast
National Economic and Social Development Board	4.5% to 5.50%	4.2% to 4.9%
Ministry of Finance	4.5% to 5.5%	4% to 5%
Bank of Thailand	4.75% to 5.75%	4.25% to 5.25%

SOURCE: THE INSTITUTIONS

even more complicated with the Supreme Court having intervened and, now, taken the lead in demanding the Election Commission's resignation. The PAD, its supporters and the main opposition Democratic Party have also resorted to Article 67 of Political Party Act, accusing the TRT of illegal conduct during the run up to the April election and calling for the party to be dissolved by the Constitutional Court. However, the Democrats, who have also called for a "royally appointed prime minister," are now themselves being accused by the Election Commission of "engaging in an act deemed detrimental to democracy and constitutional monarchy."

On June 27, the attorney general finally decided to file cases against both the TRT and the Democrats at the Constitutional Court and demand that the parties be disbanded. The battle ground has thus shifted from the street into the courtroom. The Thai legal and political system is taking a dangerous turn as the legislative and executive branches become ineffective, while the judiciary risks its credibility and political impartiality by becoming directly involved in the political conflict.

Not surprisingly, the impact of the political turmoil on the Thai economy has

started to be felt strongly. An economic slowdown, already initiated by rising energy prices and higher core inflation, has set in since the beginning of 2006. Private consumption spending weakened considerably in the first four months of 2006, as indicated by the low year-on-year growth in retail sales, passenger-car and motorcycle sales, and consumer-goods imports. Even more marked was real investment spending which took a sharp downturn over the same period with falling construction-material and commercial car sales and very weak growth of capital-goods imports. The slowdown is also a direct result of the Bank of Thailand's hawkish anti-inflationary policy of raising its 14-day repurchase rate by 100 basis points to 5% from 4% during the period of January to June 2006.

The clearest immediate sign of negative sentiment can be seen from the Stock Exchange of Thailand. The SET index followed a downward trend throughout the first six months of 2006, dropping by 9% to 649.74 points on June 21 from 713.73 points at the end of December 2005. The monthly market turnover fell sharply to 308 billion baht in May 2006 from 672.1 billion baht (\$17.5 billion) in January, a drop of 54.2%, while the daily average turnover declined to 15.4 billion baht in May from 32 billion baht in January, or a reduction of 51.9%. Market capitalization also dropped to 5.1 trillion baht at the end of May 2006 from 5.4 trillion baht at the end of January, a loss of more than 365 billion baht, or 6.7% over the period of five months. Noticeably, local investors were the most affected.

A more ominous sign for the future of

the Thai economy is the level of applications for the Board of Investment promotion privileges, which signal a sharp reduction in new investment. Although the number of applications increased to 521 projects for the first five months of 2006 against 465 for the same period of 2005, as the table on page 50 shows, the absolute amount of investment actually declined to 128.6 billion baht from 346.6 billion baht, or a drop of 62.9% over the same period. The negative sentiment was shared by Thai and foreign investors alike as the reduction was consistent across Thai and foreign applications. For this reason, Finance Minister Tanong Pittaya openly admitted on June 21 that political instability was the most serious concern among investors.

As the table on the previous page shows, most official sources have also revised their forecast for Thailand's 2006 GDP growth downward. The Federation of Thai Industries, the most important private-sector industrial association, is even more pessimistic, expecting 2006 GDP growth to be as low as 3.5%.

Business surveys have confirmed the negative sentiment in the local business community. A survey of 89 businesspersons nationwide conducted by the BOT during January-March 2006 clearly identified the current "political instability" as one of the five major reasons for pessimism and investment slowdown. The monthly Business Sentiment Index as calculated by the BOT also weakened continually to 45.0 points in February and 43.5 points in April 2006 from 45.2 points in January. The government has so far tried to maintain positive investment sentiment by confirming

that the large-scale infrastructure investment projects, although delayed, are still in the pipeline, while Bangkok's newly finished Suvarnabhumi Airport, one of the largest in Asia, will be open for commercial operation by the end of this year.

The outcome of the current political stalemate remains uncertain. The deliberation of the Constitutional Court on the cases of the TRT's and the Democrats' alleged misconduct will take months. Most political observers believe that the dissolution of both parties is highly unlikely as this will provoke a severe political crisis. The most likely scenario would be the resignation of the Election Commission, and a reconstitution of a new Commission by the Senate, which would take at least 45 days. Then the new Election Commission will allow a period of 90 days for politicians of all sides to switch their party membership before the election if they wish. This will be followed by a period of 60 days for election campaigns and another 30 days after the election for the new parliament to convene and elect a new prime minister.

Under this scenario, the earliest new general election would be held around January 2007, with the new cabinet taking office in March 2007, amounting to an administrative void of more than a year since the dissolution of parliament in late February 2006. Meanwhile, all economic and social reforms will be on hold. With such a long delay in the political process, Thai democracy, its constitution and its legal and judiciary institutions as well as the country's long-term economic competitiveness and performance will suffer. ■



Scuttling Hopes for Hong Kong's Tamar

by Adrian Ho



A TINY PATCH OF land facing Hong Kong's Victoria Harbor, the Tamar site has been symbolic of the push and pull over Hong Kong's future. Over the years it has been the object of endless controversies, coveted at various times by the colonial British, the Beijing authorities, influential land developers and fledgling NGOs.

More recently, as the Hong Kong public has become more insistent on having a democratic voice in government, the site has again become the center of debate. The government is seeking to build a \$5.2 billion administrative complex for itself on the site, and those who hope to check the power of the civil service have rallied against it. But civil society groups, who wanted something more than just another soulless Hong Kong high rise, now appear to have been defeated by the popular new Chief Executive Donald Tsang.

The site was named after the HMS Tam-

ar, a 4,650-ton troopship that first sailed into Hong Kong harbor in 1897 and served as a floating military base before being scuttled during the Battle of Hong Kong. The memory of the ship was preserved, however, when in 1978 its name was given to the new British military headquarters built on the waterfront between the Central and Wanchai districts of Hong Kong Island. In 1993, the British relocated the base to nearby Stonecutter's Island, despite strong objections from Beijing. The Chinese government was counting on inheriting the base after the colony returned to the mainland in 1997 and installing a strong People's Liberation Army presence in the heart of Hong Kong. Beijing described the move as an "absolutely unacceptable, unilateral decision."

Today, Tamar is little more than a parking lot, a veritable concrete wasteland. But

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not for much longer, as Mr. Tsang's slogan of "good, strong governance" is about to turn it into a monument to government power.

False Starts

THE FIRST AND obvious option all along, given Hong Kong's history of favoring land sales and commercial development, was simply for the government to sell Tamar to the highest bidder. It was estimated in 1994 that the property would fetch HK\$22 billion (\$2.8 billion) on the open market. But the Asian Financial Crisis in 1997 and a crash in property values made a sale impossible, and so the government decided to hold on to the site.

Then in January, 1998 it was announced that the government and legislative offices would be transplanted from their existing location deep in the heart of Central to the waterfront at Tamar. A straight exchange of the new buildings for the old—the latter would be sold once the market improved—would nullify any loss in government land-sales revenue.

But this was not to be a quick process. What followed were deliberations that dragged on until 2003. Among government, civil society and the general public, there was a growing awareness that Tamar—one of the last strategically located waterfront properties on Hong Kong island—had the potential to become a flagship development for the city. This was a period of growing self-awareness in Hong Kong: The desire for democratization was gaining momentum; citizens began feeling a growing need to sustain their city's international reputa-

tion; and the debate over whether culture and aesthetics should override pragmatism and the economy began to take shape in public forums. What did Hong Kong want to say through Tamar?

Civil society groups called for designs that would offer a "sense of place and ownership," a green, public promenade in a park-starved city. Intense navel gazing ensued—comparisons to London's Covent Garden and New York's Central Park, among others, were bandied about.

Meanwhile the chief executive at the time, Tung Chee-hwa, insisted on building new government offices at the site. The existing government facilities, he argued, were too old and too small, designed as they were at the dawn of Britain's reign in the region. He proceeded to push through with approvals for his plan.

There were suspicions meanwhile that Mr. Tung was simply acting on instructions from above. One theory was that Beijing wanted a central, highly visible monument to power that would allow post-1997 Hong Kong to shed itself of the relics of its colonial legacy.

Then in May, 2003, as Hong Kong and much of the region battled with the economically crippling outbreak of Severe Acute Respiratory Syndrome (SARS), and less than a week before the government was to submit its Tamar plans for funding approval, it was announced that the project was to be postponed. The official explanation was that the SARS outbreak had put an excessive burden on the deficit budget, and consequently all nonessential expenditures were to be reviewed and reconsidered. But some speculated that Mr. Tung

What did Hong Kong want to say through Tamar? Now we will never know.

was having second thoughts—that he had lost his confidence in the project, or was worried he didn't have the political strength to see it through. Whatever the reason, Tamar was largely forgotten and languished until Mr. Tung resigned from office and Mr. Tsang took his place.

Enter, Donald

AS ONE OF his first objectives as chief executive, Mr. Tsang announced last year that he would be reviving the Tamar government office plan. Opponents immediately dug in their heels. Since the first round of Tamar debates, Hong Kong had witnessed a half-million strong democracy march, increasingly frequent and vocal calls for a timetable for universal suffrage, and even the anti-WTO riots of December 2005. The sentiment in Hong Kong for popular political participation had never been stronger.

Objections to Tamar came from various fronts. Some saw the project as an egotistical extravagance on Mr. Tsang's part; others lamented the fate of the current government buildings, which would be destined for demolition. Questions were raised regarding the wisdom of deeper government centralization, as well as the convergence of executive and legislative branches at one site. One group even proffered the argument that Tamar's bad *feng shui* would adversely affect Hong Kong's fortunes. Once again, the city asked: What did it want to say through Tamar?

The pro-Beijing Democratic Alliance

for the Betterment of Hong Kong (DAB) was among the most vocal opponents of the Tamar project. As an alternative, it proposed that government offices move to the vacated lands of the former Kai Tak Airport across the harbor in Kowloon. Ever since a new airport was opened on nearby Lantau Island in 1998, the expansive 328-hectare Kai Tak property, like Tamar, has been left unused. Moreover, economic activity in the surrounding neighborhoods had gone down. Building the offices at Kai Tak would give the area a new economic lease on life.

Such a move would also have brought the seat of Hong Kong government back to Kowloon. In symbolism-rich Chinese culture, this would have been an important gesture toward Beijing—relocating to Kai Tak would be seen as moving closer to the embrace of the motherland.

Civil society groups, on the other hand, chose to focus on Tamar's planning demerits. Questions of land use, traffic and environmental impact were raised. Sophisticated models and surveys were commissioned to compare outcomes of the official design with the groups' suggested improvements. There was also speculation that Tamar was contaminated with dioxins from its days as a naval base.

But Mr. Tsang was having none of it. He refused to address any of these concerns, claiming in May that public support for Tamar had already reached 70%. When local media tried to corroborate Mr. Tsang's claims by conducting independent polls,

their results showed otherwise. A survey by the South China Morning Post, for example, found that support for the government's Tamar plan was closer to 30%.

This only prompted Mr. Tsang to change tack. Instead, he convinced the DAB to reverse its stance on Kai Tak and support the chief executive's Tamar plan. No one knows what deal, if any, was brokered between Mr. Tsang and the DAB, but Mr. Tsang's successful lobbying meant that he had secured enough votes to win approval for the \$670 million funding approval. On June 29, the finance committee of Hong Kong's Legislative Council gave Mr. Tsang the money he needed. Sir Donald had won.

Tamar's Post Mortem

SO WAS ALL the fuss over Tamar worth it? After all, who cares if Hong Kong adds another ugly, short-sighted development to its already long list of concrete malls and empty cultural centers that deface this once beautiful city?

What about the ordinary men and women of Hong Kong, living in high-rise government housing estates far away from the tony waterfront areas of Hong Kong island?

Should they be more concerned about healthcare, education and the economy, and leave Tamar to a select group of over-educated, cosmopolitan middle class?

In a sense, they have. A June poll by the University of Hong Kong pegged Mr. Tsang's popular support at 66%. Many suspect spirits have been buoyed by positive economic indicators: GDP growth is at 8.2%, while unemployment fell to a 57-month low of 4.9%. It's enough to make pragmatic Hong Kongers forget such trifles as democracy and political participation. The media has similarly moved on, resigned now to focusing on entreaties to Mr. Tsang to spend the \$670 million wisely.

This is a shame, because Tamar was never simply about the land. At the heart of the matter was the search for a civic identity, an opportunity to determine Hong Kong's approach to development. More than just a construction project, Tamar had the potential to give words to the voice of democracy. As in real democracies, Hong Kong's middle class seemed ready to carry the day. By shutting them out, Mr. Tsang sent a powerful signal about the way he intends to run Hong Kong in the future. ■



REVIEWS



CHINA: THE BALANCE SHEET
by C. Fred Bergsten, Bates Gill,
Nicholas R. Lardy and Derek Mitchell
Public Affairs, 256 pages, \$25

**ORACLE BONES: A JOURNEY BETWEEN
CHINA'S PAST AND PRESENT**
by Peter Hessler
HarperCollins, 512 pages, \$26.95

Reviewed by HUGO RESTALL

HOW TO SUM up the state of China? One way is to gather America's top experts on the country's economy and political system and write a book by committee. The other is to drive out to the factories and fields and talk to ordinary people struggling to improve their lives.

Not surprisingly, the first approach yields a boring book. If you need a summary, say, of the demographic trends facing the country, *China: The Balance Sheet* is a good resource. However, while its stated goal of helping to educate U.S. policy makers is a noble one, the book reads like the reports they already get from the Congressional Research Service. The title also overreaches, since even the best data available is sketchy; this should really be called *China: The Consensus Estimate*.

Peter Hessler, a Beijing-based writer accredited with the *New Yorker* magazine, takes the second approach, and succeeds in bringing us closer to an appraisal of China's social balance sheet, while preserving a sense of the ambiguities of past and present. His first book, *River Town*, was a bril-

liant account of life as an English teacher on the banks of the Yangtze River. This time he draws on a much bigger canvas.

Oracle Bones starts off a bit slow, setting the stage with several strands of narrative. These are interesting in themselves, but they seem unrelated, the products of serendipitous discoveries made in the course of mundane reporting assignments. Then, about halfway through the book, the strands begin to intertwine.

For instance, after running across a Chinese-American author who lived in Chicago, Mr. Hessler asks him if he knew Chen Mengjia, an expert on bronzes and oracle bones—the turtle and cow bones used for divination in the Shang Dynasty, on which were carved the oldest surviving Chinese characters. Turns out he not only knew Chen, who went back to China and eventually committed suicide under torment of the Cultural Revolution, but he knew his wife too. Her name is familiar, because we've run across her 50 pages earlier, as part of another story. In this fashion, the reader makes connections along with the author.

However, this is far from just a typical journalist's summing up of his years in China. In self-deprecating style, Mr. Hessler says he would make a lousy newspaper reporter, abhorring deadlines and talking to people on the phone. Instead he spends days, sometimes weeks poking around a mundane story, waiting for the unusual to pop up. And when it does, he pursues it for years.

Some of his best material comes from former students like William Jefferson Foster and Nancy Drew—their chosen English names are suggestive of an almost

— Mr. Restall is editor of the REVIEW.

American flair for self-reinvention. The young couple dodge assigned teaching jobs in the Sichuan countryside and make their way to a private school in entrepreneurial Wenzhou. Meanwhile, Emily searches for meaning in her life while working in the boomtown of Shenzhen. All three run up against dishonesty and corruption, yet manage to rise above it.

Through them, a sense emerges of how a younger generation is escaping the strictures of their parents' blighted generation, and recapturing the virtues of their grandparents' time. They embrace the momentous decisions about what kind of life path suits their own personalities. While China is still thought of as a top-down, authoritarian society, in fact it is changing from the bottom up.

Many threads lead back to Chinese attitudes toward the past. The phrase "5,000 years of history" is an oft-used talisman that proclaims the country's special status. But only about half of that period could properly be called history. And some of the most cherished assumptions about Chinese civilization—for instance that its only cradle was the Yellow River valley—are increasingly open to question.

What's more, modern Chinese have only a tenuous understanding of and connection to their own past. Government leaders certainly don't know much about it—understandably, since the first and second generations of Communist Party leaders were peasant fighters, and the third are Soviet-trained engineers. The Cultural Revolution broke the line of transmission for many traditions. Mao Zedong's simplification of written characters has tended to separate modern Chinese from their literary past—Chen Mengjia's opposition to this "reform" led to his death.

But more fundamentally, in the last century China has turned to the West for its cultural underpinning. David Keightley, a history professor at Berkeley, discuss-

es how an effort to incorporate Western ideas in and of itself undermines a conservative culture based on ancestor worship. He wrote:

...Whether in the Marxism of Mao Zedong or the yearnings for democracy of student dissidents after him, the West has, for better or worse, now become, to a significant degree, China's Greece and Rome.

The Asian Games, recently held in Beijing, like the Olympics that the Chinese hope to host ... can thus be seen as the descendants of the games that Achilles held for Patroclus's funder.... They serve as one example of China's attempt to appropriate part of the West's classical and now international heritage into China's modern culture.

Does that mean China will necessarily get along with the West? Or is it culturally orphaned, meaning it will react with anger to the inevitable rejections, like the 1993 failed bid to host the 2000 Olympics?

There are no pat answers here. In fact, as Mr. Hessler finds in his incessant interviewing of friends in low places, the same Chinese person may present radically different attitudes toward the outside world depending on the topic of conversation and mood of the moment.

That mirrors his difficulty getting to the bottom of the Chen Mengjia story. One man who started out in Part Two a heroic battler against the system is shown to have a darker side, while another who seemed like the villain of the piece ends up being a sympathetic character.

This shouldn't be misinterpreted as a message that the truth of China is unknowable, or that outsiders shouldn't try to understand it. But it is a warning that trying to summarize China's development is a dicey business.

One recurring theme is the clip files of The Wall Street Journal's Beijing bureau, which Mr. Hessler was once involved in

While China is still thought of as a top-down, authoritarian society, in fact it is changing from the bottom up.

maintaining. When confronted with a new scrap of information, he frequently flashes back to the name of the file where it might get pigeon-holed. The point is that such categories are hopelessly inadequate when it comes to capturing China's ferment. They provide a weirdly appropriate parallel to another recurring device, quotations from the scraps of writing on the oracle bones by which the primitive Shang kings sought to make sense of an uncertain world. If clip files and balance sheets are the modern oracle bones, we need more of Mr. Hessler's style of holistic, first-hand investigation of China's reality.

**THE MAKING OF THE
"RAPE OF NANKING":**

**HISTORY AND MEMORY IN JAPAN,
CHINA, AND THE UNITED STATES**
by Takashi Yoshida

Oxford University Press, 278 pages, \$55

Reviewed by MARTIN LAFLAMME

AS PRIME MINISTER Junichiro Koizumi nears the end of his term, one question looms large in the mind of many observers: will he visit Yasukuni Shrine one last time? Some fear he may even do so on Aug. 15, the day that marks the end of the war in the Pacific. This, no doubt, would profoundly annoy those countries, such as China and Korea, which have most directly borne the brunt of Japanese colonialism. It would also reinforce a growing—if mistaken—impression

that, more than 60 years after the end of World War II, Japan still refuses to take a hard, honest look at its past. In the eyes of many, the no-compromise stance of Mr. Koizumi has come to personify that of his nation: unrepentant.

This is a real pity. When it comes to World War II, Japanese views are far from homogeneous. As Takashi Yoshida makes clear in his superb study of the memories of the Nanking massacre, Japan has been at pains to come to terms with the legacy of its imperial adventures for decades. In the lively and contentious debate that continues to rage, all sorts of voices have been heard, including those of right-wing revisionists. Unfortunately, it is their sometimes shocking opinions that have tended to attract most foreign media attention, and this has strengthened the impression that they speak for a large segment of the population. What often goes unnoticed is what prompted them to speak in the first place, namely, the equally strong sentiments of the pacifist left, which are, in fact, vastly more representative.

Today Nanking stands as the prime symbol of Japanese wartime aggression. Yet this has not always been the case. Although the Nationalist government of Chang Kai-shek had addressed the League of Nations as early as February 1938 to denounce the excesses of Japanese imperial troops in Nanking, it preferred to draw the world's attention to Japan's chemical warfare. Many in Europe had vivid memories of the poison gas attacks of World War I, and so these were deemed more helpful in persuading the international community to take action against Japan. In those early days, the Nanking massacre was "only one of many such outrages visited on the nation by the Imperial Japanese Army."

Mr. Laflamme is a Canadian diplomat currently serving in Tokyo. The views presented here are his own.

During the war, few Japanese had really understood what had taken place in Nanking. With the establishment of military tribunals across Asia in 1945, wanton acts by Imperial troops were finally made public, but the onset of the Cold War soon focused people's attention elsewhere. In the early 1950s, for example, Beijing was much more concerned with U.S. "barbarity" on the Korean peninsula than with what had happened under the Nationalists in Nanking. As for the Taiwanese elite, postwar economic links with Japan took priority. In any case, drawing attention to Nanking would only serve to show how ineffectual their government had been in defending the city. Better to let sleeping dogs lie.

What really put Nanking on the international radar was a nasty controversy over history textbooks that erupted in Japan in 1982. Early that year, reports started to appear in the local media describing how new government-approved manuals seemed to downplay the negative aspects of Japan's war record. Although those articles were not entirely accurate, Seoul and Beijing lodged formal protests.

Tokyo eventually backed off, but this only served to anger Japanese conservatives on the right. Two years later, a number of war veterans decided to sue the government for 7 million yen (\$60,000), arguing that some of the new textbooks "unfairly exaggerated the cruelty of the Japanese military." In response, groups of private citizens, outraged by this and other claims that Nanking was just a fabrication, established their own research committees to publicize what was known about the tragedy. A pattern was starting to emerge, one in which a series of actions and counteractions by groups on both sides of the issue helped fuel the flames of the debate. It continues to this day.

According to Mr. Yoshida, an assistant professor of history at Western Michigan University, the Ministry of Education

"had long used its powers of authorization to tone down textbook descriptions of Japan's wartime aggression," but by putting the government on the spot, and focusing public attention on the teaching of history, the textbook controversy of 1982 helped to provide authors with more freedom. They began to quote higher death tolls and, by 1997, six out of seven junior high school textbooks available reckoned the number of deaths ranged between 100,000 and 200,000, while four of them also mentioned the official Chinese estimate of 300,000.

The textbook controversy echoed beyond the borders of Japan. American newspapers, for example, were quick to report on the dispute. Unfortunately, they also tended to dwell on the views of the revisionists, and thus readers were often given the impression that Japan was merely trying to expunge its military past from public memory, while in fact it was wrestling with it.

By comparison, the Chinese press, at least in those days, was more balanced in its accounts. It always made a point to distinguish the views of a "tiny elite" or the "few militarists" from those of most ordinary Japanese. This attitude changed somewhat in the 1990s, however, when, following the Tiananmen Square incident, patriotic education campaigns were ratcheted up. Although the mainland media continued to point out that revisionists were few in number, they became increasingly less tolerant of this minority. By the end of the century, Mr. Yoshida explains, anyone questioning any part of China's official version of the massacre "was likely to be labeled a denier of the event itself."

Nanking remains a contentious issue today. Arriving at "a shared idea of truth across national boundaries" has proved challenging. It is also very likely to remain so. In recent years, Japan's war record has become such a hot political issue that it is hard to imagine how a common narrative

Japan's war record has become such a hot issue that it is hard to imagine a common narrative satisfying all sides.

could be created to satisfy all sides.

But contrary to the fears of many, the debate in Japan is still vigorous. It certainly has not been hijacked by right-wing militarists. To illustrate this, witness the fact that all major national dailies but the Sankei, which accounts for less than 5% of total circulation, now oppose prime ministerial visits to Yasukuni Shrine. The very public and thoughtful exchange on Japan's war past between Tsuneo Watanabe, editor in chief of the Yomiuri Shimbun, and Yoshibumi Wakamiya, chairman of the editorial board of the Asahi Shimbun, has also contributed to keeping this issue very much in the public eye. One only wishes there were more books such as this to help us navigate the shoals of Asia's complicated war legacy.

**NORMALIZATION OF
U.S.-CHINA RELATIONS:
AN INTERNATIONAL HISTORY**
*Edited by William C. Kirby,
Robert S. Ross, and Gong Li*
Harvard University Press,
425 pages, \$49.50

Reviewed by AMY E. GADSDEN

IN 1793 LORD George Macartney visited China, urging the Qing Empire to establish trade and diplomatic relations with Great Britain. Considered a watershed in the history of Chinese international relations, the encounter is often remembered for two events: the Qing emperor's rejection of Macartney's overture, about which he

made the famous statement that China set "no value on objects strange or ingenious" and had "no use for your country's manufactures"; and Macartney's refusal to bow before the Qianlong emperor. For historians, it stands out as an illustration of imperial China's resistance to foreign engagement and Great Britain's insistence on extending its imperial reach, as well as an archetypal moment in international relations when a meeting between powers set the course for the following century's engagements and clashes.

In the early 1970s, a modern-day Macartney mission again launched China on a path of international engagement. U.S. Secretary of State Henry Kissinger's secret mission to China in 1971 and President Richard Nixon's trip the following year have acquired similar significance in the study of Chinese diplomatic relations. Mr. Kissinger's secret detour from Pakistan, the "strange bedfellows" meeting between Nixon and Mao, and the wrangling over the language of the Shanghai Communiqué are diplomatic moments that scholars and analysts return to repeatedly to understand how states' international trajectories are shaped. Now that archives from this period in the United States, China, Taiwan and the Soviet Union have recently become available, scholars can weigh the personal accounts of the participants against the evidence of the historical record.

Normalization of U.S.-China Relations examines the establishment of diplomatic ties between the two countries in light of these new archives. The volume itself is a product of the normalization efforts, since it is a collaboration between Chinese and foreign scholars. It also provides a stark contrast between the Chinese and foreign understanding of events.

~ Ms. Gadsden is the China program director for the International Republican Institute.

The central question for much of the book is how America's relationship with Taiwan factored into negotiations. Though they created an illusion of remaining loyal to Taiwan, Mr. Kissinger and Nixon were bent on normalizing relations with Beijing, even secretly providing assurances to the People's Republic of China that the U.S. would accommodate China's Taiwan concerns in the long run. Robert Accinelli's conclusion, shared by Rosemary Foot, is that Mr. Kissinger and Nixon gave away too much with respect to Taiwan: They failed to pursue opportunities to push the P.R.C. to offer greater assurances that it aspired to peaceful resolution of the unification question. Ms. Foot also argues that pledges made in the early 1970s tied the hands of the Carter team later on.

The volume speculates as to whether the P.R.C. was willing to compromise when it came to Taiwan (and perhaps it was not), but it is more explicit regarding the U.S. leaders' vision of Taiwan's future. Nixon and Mr. Kissinger assumed that the Taiwan problem would disappear shortly after normalization, when an isolated and weak Republic of China regime would have no choice but to reconcile with the mainland. We have no way of knowing whether the P.R.C. shared this confidence.

In the immediate aftermath of the Nixon visit, Taipei appealed for support by denouncing the "communist gangster clique," paradoxically considered reaching out to the Soviet Union, and flirted briefly with developing nuclear capabilities. It quickly abandoned this strategy for a "smiling diplomacy" characterized by economic and cultural initiatives, bolstered by political reform at home. Nixon's 1972 *volte-face* on the question of who represents China was a shock to Taiwan's system, but one that contributed to a series of changes that has arguably preserved the island's status.

The book's remaining chapters look at U.S.-China normalization in the context

of the Cold War and the war in Vietnam. Wang Zhongchun reminds us that while Taiwan might have been the major point of contention during the negotiations, the glowering specter of the U.S.S.R. made clear the common cause shared by the U.S. and China. Mr. Wang contends that the main obstacle that delayed normalization until the late 1970s was not Taiwan, but in fact the U.S. *détente* with the U.S.S.R.

A final comment must be made about the international nature of this volume. It becomes clear when reading these contributions together that Chinese and foreign scholars understand the importance of U.S.-China normalization differently.

From the U.S. perspective, the establishment of diplomatic ties with China was important in part because of the immediate and long-term implications for Taiwan, but its larger significance was as part of the U.S. policy toward Russia and the shifting power balances of the Cold War. For China, opening relations with the U.S. quickly became more than just a diplomatic maneuver in response to a Soviet threat; it opened the country to the West, enabling fundamental reforms in the economy, society and polity that are ongoing today. It is no surprise then that in their conclusions the Chinese contributors emphasize that the basis for U.S.-China relations runs deeper than the Cold War, stressing the shared interests of both sides and the importance of the relationship for "global peace and development."

To a non-Chinese reader, this emphasis on the significance of the relationship may seem excessive. But if Lord Macartney's mission symbolized the Chinese rejection of engagement with the West, Nixon's visit and the normalization of relations marked China's acceptance. Today's China—its rapidly changing society, its booming economy and its transitioning polity—was born from the decision to "open up," a decision whose consequences are still playing out.

China's relationship with the U.S. became more than just a diplomatic maneuver, it opened the country to the West.

**UNDERSTANDING CHINA AND INDIA:
SECURITY IMPLICATIONS FOR THE
UNITED STATES AND THE WORLD**

by Rollie Lal

*Praeger Security International,
200 pages, \$49.95*

Reviewed by ROBERT M. HATHAWAY

THE END OF the Cold War and the terrorist attacks of September 11 encouraged analysts to reconceptualize the nature of today's security threats. Failing states, rogue nations, and stateless terrorists have seized center stage; relations among the world's great powers, some have concluded, are less important today than at any time in the past several centuries. Rollie Lal, the author of *Understanding China and India*, begs to differ. But, she adds, it is time to revise the traditional Eurocentric roster of great powers: In the 21st century, China and India must be included.

China's transformation over the past quarter century has been absolutely unprecedented. In the late 1970s, it was an impoverished developing country. Today it is an economic dynamo, a rising military power, and a country whose influence permeates Asia and, increasingly, the rest of the world. India got a later start than China, and its growth has been somewhat less eye-catching. Nonetheless, it too is on a steep upward trajectory, making it a major actor on the global scene in the coming years. Developments within each of these powers—as well as relations between them—will go a long way toward defining the world our chil-

dren will inherit. Moreover, the manner in which the United States orders its relations with each will also have a significant impact on the course of the 21st century, and on whether the present century proves less grim than its unhappy predecessor.

Ms. Lal, an analyst at the American think tank RAND, seeks to understand how elites in China and India define their national interests. What, she asks, are the perceptions of threat held by Chinese and Indian officials, scholars, and journalists? Noting that the two countries have adopted similar policies of economic reform and defense modernization, she finds that they hold decidedly different conceptions of national interests, which reflect divergent threat perceptions.

China remains obsessed with the dangers of disunity and collapse. Territorial sovereignty and the imperative of maintaining control over Tibet, Xinjiang, and especially Taiwan preoccupy Beijing decision makers.

Indians, on the other hand, are remarkably relaxed about national unity, even about the Pakistan-aided insurgencies in Jammu and Kashmir. Instead, Indian elites are most concerned with the pressures of globalization, and worry about protecting India's political and economic independence in areas such as trade, labor rights and environmental standards. Even such military measures as an expanded navy or enhanced missile capability are viewed primarily as tools to maintain sovereignty of decision making rather than in terms of conventional defense.

The very different political systems of the two countries also shape the perception of threats held by elites. Ms. Lal's Chinese interlocutors harped on the potential for social unrest and the institutional frail-

Mr. Hathaway is director of the Asia program at the Woodrow Wilson International Center for Scholars in Washington, D.C.

ties of one-party rule in China. Social unity is endangered as a result of a weak concept of national identity. Fragile institutions and contested political legitimacy produce policies focused on preserving stability. Indians seem not to share these anxieties, as India's robust multiparty parliamentary democracy has provided the country with a secure national identity. Unlike in China, Ms. Lal asserts, political legitimacy is not at issue in India.

These conclusions are derived from more than 100 interviews with Chinese and Indian officials, academics, and others who either shape or reflect elite opinion. While such interviews can provide important insights into national perceptions, basing a book entirely on this methodology invites skepticism. A survey of elite opinion in India, for instance, would not have predicted the 2004 electoral triumph of the Congress Party and its allies.

Notwithstanding the implied promise of the book's subtitle, Ms. Lal devotes barely more than a page to the implications for the U.S. of the emergence of these two Asian powers. U.S. decision makers, she warns, should note that China is prepared to jeopardize its continued economic development in order to retain sovereignty over Taiwan. Moreover, domestic politics are "crucial" to the Chinese leadership.

With respect to India, Washington should look for "cooperative solutions through international organizations that incorporate India's concerns." America's use of force in the Persian Gulf, Kosovo, and Iraq have unsettled decision makers in Beijing and New Delhi and led both countries to conclude that a strong military with a credible nuclear component is essential to protect against bullying by stronger powers. These are hardly earth-shaking conclusions, although Donald Rumsfeld would contest the last one.

Might Washington successfully play one Asian giant against the other, or draw

India into an anti-China partnership? Here Ms. Lal is somewhat more definitive. Certainly it is not difficult to spin out a scenario where rivalry, possibly even conflict, is the predominant element in relations between China and India. Even now, they are jockeying for influence in Southeast Asia and in the smaller South Asian states, such as Nepal, Bhutan, and Bangladesh. Their history, moreover, has been difficult; in India, defeat in the 1962 war with China still rankles.

And yet, Ms. Lal persuasively argues, there are powerful pressures at work in both countries that push in the direction of cooperation rather than confrontation. Engagement between the two—political, economic, diplomatic, even military—is at an all-time high. The disputed border issue is not as volatile as it once was. Economic ties, while still modest, are growing rapidly. At a trade conference in Mumbai earlier this year, 200 Chinese officials and corporate executives showed up; many of China's top companies are eager to invest in India, especially in infrastructure projects. Even Beijing's ties with Pakistan are not the irritant for New Delhi they used to be, as China has backed off from its former unvarnished support for Islamabad on issues such as Kashmir.

The good news, according to Ms. Lal, is that China is not aggressive or expansionist. Beijing will remain inwardly focused for many years to come, concentrating on economic development and trying to maintain control over a restive population. Neither China nor India has any particular interest in bringing down the current international system—a system largely created by the U.S., and that still works to Washington's advantage. America's task, therefore, is to ensure that the two new players in the great power game continue to believe that it is in their own long-term interests to work within the rules of the present global order.

There are powerful pressures in China and India that push in the direction of cooperation rather than confrontation.

**WHO THE HELL ARE WE FIGHTING?
THE STORY OF SAM ADAMS AND THE
VIETNAM INTELLIGENCE WARS**

by C. Michael Hiam

Steerforth Press, 316 pages, \$25.95

Reviewed by GREG RUSHFORD

AMERICA IS AT war. The president's men stand accused of pressuring U.S. intelligence officials to cook the books, persuading the public into believing that the enemy is on the wane. Prodded by a brilliant CIA analyst—a man who courageously refuses to go along with the falsifications, even at the cost of his career—a few honest military and civilian intelligence officers try to resist the pressures. Alas, the intrepid spooks stand by helplessly as their politically compliant leaders cave to powerful White House and Pentagon operatives. Only after the lies and bureaucratic cowardice have contributed to the tragic loss of American lives on the battlefield do the CIA's top leaders tell a shaken president the unvarnished truth.

Although the story has a disconcerting déjà vu quality to anyone following today's headlines, Michael Hiam's account involves events during the Vietnam War. Nevertheless, it is a timely reminder that clashes between strong-willed policy makers and intelligence officials who dare to report politically inconvenient facts are not a recent phenomenon to Washington.

Mr. Hiam tells the story of CIA analyst Sam Adams, whose brilliant research in 1966-67 uncovered an awkward fact: American forces were facing, at a mini-

mum, at least a half million Viet Cong guerrilla fighters. This was decidedly unwelcome news. President Lyndon Johnson and his military command in Saigon, led by Gen. William Westmoreland, had been telling the American people that there were only about 285,000 Viet Cong forces, which were "declining at a steady rate."

Worse, Gen. Westmoreland had seen—and suppressed—intelligence findings showing enemy forces hardly in decline. "We have been projecting an image of success over recent months," Gen. Westmoreland's deputy, Gen. Creighton Abrams, candidly acknowledged. The "command position," Gen. Abrams emphasized, was that some categories of irregular fighters, called "self-defense" and "secret self-defense" forces—folks who were in the business of killing Americans with everything from hand grenades to booby traps—must be dropped from the official order of battle. Under no circumstances was the military to allow the official estimate of Viet Cong forces to rise above 300,000.

At the CIA, working-level analysts were incensed. As an incredulous Adams put it, "Here we are in the middle of a guerrilla war, and we haven't even bothered to count the number of guerrillas." Some military officers shared that outrage. As Col. Don Blascak, then a Special Forces major on assignment with the CIA, rightly put it, 10-year-old kids with AK-47s could kill Americans just as dead as the enemy's main forces.

Adams and his working-level colleagues at the CIA fought a vigorous rear-guard battle to keep the Order of Battle honest. But CIA Director Richard Helms and his top analyst for Vietnam, George Carver, ultimately decided in September, 1967 to keep the estimate below 300,000, as the military com-

∞ Mr. Rushford is editor of the *Rushford Report*, an online newsletter that specializes in national security and trade politics.

mand demanded. This was "nothing less than the prostitution of intelligence," Mr. Hiam writes. But calculating that the Johnson administration did not want to hear the unvarnished truth anyway, Messrs. Helms and Carver decided to go along until a more suitable opportunity arose to wage bureaucratic warfare with the military.

That opportunity came four months later, during the Tet lunar holidays on January 30, 1968. The Viet Cong—including the couple hundred thousand irregular forces the Westmoreland command had pretended did not exist—launched a surprise attack that targeted nearly every major provincial capital, setting South Vietnam aflame and even sending a sapper team into the U.S. embassy in Saigon. The Tet Offensive ultimately failed, at least in a military sense, as the guerrillas were beaten back—but a disillusioned American public would never again support the war.

After Tet, Gen. Westmoreland asked the White House for 206,000 additional troops; the request was denied. Mr. Helms promptly sent Mr. Carver to brief the president on the true extent of the Viet Cong force. Lyndon Johnson announced soon after that he would not stand for re-election.

I have a special feeling for this book. Sam Adams became my friend. In 1975, as an investigator for the House Select Committee on Intelligence, I pored through reams of formerly secret documents from the CIA, the Pentagon, and the National Security Agency that confirmed Mr. Adams' findings. At the time, however, very few of Adams's colleagues in the CIA—some of whom were to eventually express their shame—were willing to step forward. Mr. Hiam reports that CIA Director William Colby encouraged potential congressional witnesses to toe the company line and downplay the significance of Adams's discoveries.

The official cover-up finally came apart in 1982 when CBS News broadcast *The Uncounted Enemy*, a documentary in which

a number of former key military and CIA officials, including Mr. Allen, finally went public. Proclaiming his innocence, Gen. Westmoreland then sued CBS for libel. But the general withdrew the lawsuit before it was put to a jury, after what Mr. Hiam calls "lethal" testimony from a series of former CIA officials and highly decorated military intelligence officials, including Gen. Joseph McChristian and Col. Blascak.

While Sam Adams has never been officially honored for his service to his country, there are still some at Langley who remember. Mr. Hiam relates that a bunch of flowers showed up at Mr. Adams' funeral in 1988, with an unsigned note:

*Oh hey Sam,
A truer friend of his country,
a better analyst and warrior
is yet to come.*

**CHASING THE SUN:
RETHINKING EAST ASIAN POLICY**
*by Morton Abramowitz
and Stephen Bosworth*

*Century Foundation Press, 165 pages,
\$15.95*

Reviewed by KIN-MING LIU

IN AN AGE when almost any research can be done with only a computer, it's admirable that the authors actually spent many weeks in East Asia talking to hundreds of executives, politicians, officials, academics and journalists in preparing for this volume. I was one of them when they visited Hong Kong in early 2005.

~ Mr. Liu, a former chairman of the Hong Kong Journalists Association and general manager of Hong Kong's *Apple Daily*, is a Washington-based columnist.

The U.S. may not be able to decide how to deal with a dynamic China given the strongly divided views at home.

The authors bring rich experiences from Asia to the discussion. Mr. Abramowitz was U.S. ambassador to Thailand and held senior positions at the State and Defense Departments, while Mr. Bosworth was ambassador to both South Korea and the Philippines. They grew up in a half century when American policy in East Asia was guided by a simple principle: "prevent the domination of the region by any power other than ourselves."

Today, however, "the era of absolute American pre-eminence in East Asia is over." According to these two self-professed "Asia hands," the U.S. relationship with the new East Asia will henceforth be determined by four interrelated issues: the way the U.S. deals with China's emergence as a great player on the international scene; the effective handling of the Taiwan and North Korean issues; how the U.S. deals with Sino-Japanese competition; and how Washington should respond to efforts to build wider and more effective political and economic cooperation within East Asia.

Setting the stage for discussion, the authors accurately observe that the U.S. faces fundamental questions about how to sort out its dealings with a dynamic China. It may not be able to answer these given the strongly divided views at home.

One side holds that China, ruled by a secretive and authoritarian Communist Party, is predestined to pursue policies that will threaten American interests. For these pessimists, it is tantamount to an "article of faith" that China, as a rising power, will translate its economic might into expanded military capability, and challenge American influence not only economically but also militarily. Defense Secretary Donald Rumsfeld's oft-quoted question—"Since no

nation threatens China, one must wonder: Why this growing investment [in military build-up]?"—is ridiculed by the authors as bordering on "the ludicrous" because the U.S. itself is by far the largest military spender in the world. "Rumsfeld's question is an important one, but it could be asked of all countries that maintain large and costly defense establishments," the authors retort.

They believe that Mr. Rumsfeld's question reflects "a deeply held belief in some quarters of the American foreign policy establishment that the U.S. has unique burdens and responsibilities, which everyone must of course recognize, and that these require a huge military edge everywhere in the world. Since we are the good guys who ride to the rescue of the weak and oppressed, any amount we spend on defense is justified, and, whatever we do, we should not be seen as a threat to anyone who does not have malign intentions." This view is not shared by much of East Asia or the world, the authors claim. Rather, many see that the U.S. "has enormous military power and has demonstrated a willingness to use that power whenever it judges it necessary to its own interests without much reference to the views of the rest of the world."

While I would be among the first to admit that the U.S. has committed its fair share of mistakes around the globe, I would also challenge critics of the U.S. with this question: Would the world be a better place without the kind of American involvements we witness? The answer should be a resolute no. East Asians, in particular, should understand that the consequences would have been far worse if Americans hadn't sacrificed in World War II, the Korean War, and yes, even the Vietnam War.

A strong and dominant U.S. presence in the region, even with its various shortcomings, is still an unequivocally the best alternative. The authors are correct that not all East Asians welcome the U.S. role in the region. But this is simply too bad. It demonstrates once again that the Americans are really a gracious people who would keep trying to do good even when not appreciated by the very people who are the beneficiaries.

The other, more optimistic view would argue that while China seeks a bigger stick, for the most part it speaks softly, working diligently to convince other countries that its growth will be a benign benefit to the world. The Chinese are also pragmatic in dealing with the U.S.—willing from time to time to bend to the American will, even on matters that involve swallowing considerable Chinese pride and that can create considerable domestic controversy.

This argument is untenable. One could just as easily say that it's an "article of faith" for the optimists to believe that China will rise peacefully. More likely, China is only "buying time."

The best evidence to illustrate the flimsiness of the optimistic argument comes from the authors' own assessment of the Taiwan situation. In the book, Taiwan is repeatedly treated as an exception to the authors' discourse. When the authors assert the unlikelihood of countries in East Asia coming to serious blows, they have to add the disclaimer "North Korea and Taiwan aside." And again, when they assert that few Asian nations have cause to worry about being bullied militarily by China, again they add the disclaimer, "except in Taiwan." "With the exception of Taiwan," the authors write, China denounces no country. When an exception recurs enough times, it's more accurate to call it a norm instead.

The authors have long felt that economics would ultimately bridge the chasm, that deepening financial stakes for both China

and Taiwan would lead to practical dialogue, preventing nationalist feelings from running amok. "We are still waiting," they say. Good luck. The authors don't seem to be bothered by the fact that as Taiwanese businesses invest more and more in China, the number of Chinese missiles pointed at Taiwan is also increasing.

I don't think the authors' views are as "unrealistic or even naïve" as they think some critics might say. But they are too optimistic.

**SECULARISM AND SPIRITUALITY:
SEEKING INTEGRATED KNOWLEDGE
AND SUCCESS IN MADRASAH
EDUCATION IN SINGAPORE**

*Edited by Noor Aishah Abdul Rahman
and Lai Ah Eng*

Times Academic Press, 208 pages, \$26

Reviewed by ROSE ISMAIL

THE MODERN UNIVERSITY and the idea of the degree owe their beginnings to Muslims. These and other contributions to science, technology, philosophy and the arts prior to the European Enlightenment validate the importance of knowledge in Islam. Until a couple of centuries ago, there were no clear distinctions between religious and secular subjects. Knowledge of God and the study of God's creation were both crucial and essential. For the early Muslims, ignoring the sciences was tantamount to not taking God's creation seriously.

Yet, Islamic religious schools—also known as madrassas—are fighting for their survival in Singapore today. By 2010, if six

Ms. Ismail, a former editor with the New Straits Times and senior fellow at the Institute of Strategic and International Studies, now heads a media consultancy in Malaysia.

For Singapore's Malay-Muslims, the fate of the madrassa is critical for both religious and political reasons.

full-time madrassas fail to achieve the standards set by the government, thousands of Muslim schoolchildren may be wrenched from a centuries-old education tradition and thrust into a school system completely unfamiliar to them. For Malay-Muslims who form a substantial minority in the island republic, the fate of the madrassa is critical for both religious and political reasons: The 2010 deadline will not only determine the fate of the institution, it will also set the tone of the relationship between the state and the community for the next few decades.

So this book is especially timely. It draws attention to the myriad problems associated with madrassa-based education, from funding to the punishing workload required for "integrated knowledge" and the worrying drop-out rate (65% in 1995) even before students reach the O-Levels. The book also highlights the fundamental dilemma facing the madrassas: the struggle to remain dedicated to religious or "otherworldly" education and the need to remain relevant to today's world.

Although books on educational institutions tend to be mind-numbing, the contributors to this volume manage to sustain the reader's interest. While several have taken the broad historical approach, a number have focused on the finer details. For instance, there is a well-researched case study of a madrassa in one chapter while another looks at different Islamic educational institutions in several countries. Perhaps the most intriguing section is the last, which explains the concept of knowledge in Islam. The fascinating comparison between past practices and contemporary realities illuminates the factors that pose problems for Muslim societies today.

One conclusion that can be drawn from this excellent collection of essays is the dire need for curriculum and pedagogical reform—not just in the Singapore madrassas but in similar institutions around the Muslim world as well. A point worth noting is the care and caution shown by all the writers. This unusual display of circumspection is probably necessary given the possessive attitude of the traditional ulama toward Islamic education. Like traditional teachers of all religions, they do not take kindly to being scrutinized in any way by secular scholars. It would not be possible, for instance, to impress upon an ulama that the madrassa is not in sync with the demands of modern society, or that it is completely isolated from broad currents of educational thinking and reform that place a high premium on skills and creativity.

Knowing full well the sensitivities surrounding the issue of madrassa education, the Singapore government took a circuitous route to solving the problem. In 1999, at a National Day rally, then Prime Minister Goh Chok Tong proposed that national education be made compulsory for every child in Singapore. Facing the full brunt of the proposed policy were six full-time, privately funded madrassas with a total student population of about 4,000. Part-time madrassas and classes conducted in mosques would not be affected.

On the face of it, Mr. Goh's proposal was pragmatic, based on the idea that it was unrealistic to assume all students entering the schools would become religious functionaries. In order to avoid high unemployment rates in the community, he and other ministers argued that young Malay-Muslims needed to be equipped with skills that would help them secure jobs in a mul-

tiracial, cosmopolitan and urban environment. The benefits to national integration and nation-building were also trotted out on many occasions.

Although Mr. Goh repeatedly assured the Malay-Muslim community that the government had no intention of closing down the institution, the compulsory education policy would have marked the beginning of the end for the madrassas. After four to six years in a national system which introduces children to art, science, music, a crop of better-trained teachers and proper facilities, it is unlikely that students or parents would want to change mid-stream.

The response was hostile. In some circles, the policy was seen as an attempt to rein in the Malay-Muslim community. Others viewed it as a shrewd move by the government to eventually close down all the madrassas. It has not helped that after September 11, many non-Muslims are fearful and prejudiced towards Muslims and Islam. The simplistic assumption that madrassas are training grounds for terrorist recruits has also tarnished the image of such institutions in Singapore.

Exemption from closure will be given only if students can satisfy the average aggregate score for Malays in the six lowest-performing schools in the Primary School Leaving Examinations in the same year. Failure will mean that the madrasa will no longer offer primary education, although it may continue to provide secondary education.

Some observers say that when it comes to the crunch, the Singaporean government is unlikely to close down the madrassas completely as the political fallout would be too great. Either way, a deadlock is not likely to benefit Singapore's Islamic community: It will either have to agree to a dilution of the original curriculum or accept the end of the full-time madrassas in Singapore.

THE LONG MARCH

by Sun Shuyun

HarperCollins, 320 pages, £20

THE LONG MARCH: THE TRUE STORY BEHIND THE LEGENDARY JOURNEY THAT MADE MAO'S CHINA

by Ed Jocelyn and Andrew McEwen

Constable & Robinson, 320 pages, £8.99

Reviewed by BENJAMIN ROBERTSON

AS SUN SHUYUN writes in the opening to her book, "Every nation has its founding myth. For Communist China, it is the Long March." Beginning in 1934, the Red Army broke out of their besieged stronghold in southern China's Jinggang mountains. Fleeing from Chiang Kai-shek's nationalist forces, they first marched west and then north, spending over a year on the run before establishing a new base in Yan'an. It was from there that they later launched a counterattack to finally drive Chiang to Taiwan.

A trek of 25,000 *li*—roughly 12,500 kilometers—through unimaginable deprivations and hardships, dramatic battles, and a steady stream of victories (all attributed to Mao Zedong), the myth of the march portrays the Party's victory as the destiny of one man. The baggage of political propaganda has, however, weighed down most accounts of the march. These have typically focused on leading personalities and battles at the expense of the average soldier whose voice, when heard, has generally been highly sanitized. These two books do much to change that.

An Oxford graduate and London-based documentary producer, Sun Shuyun's understanding of the Long March is deeply personal. Open-minded and thoughtful, Ms. Sun started her research as a self-pro-

Mr. Robertson is a free-lance writer based in Beijing.

The Red Army kidnapped and ransomed peasants on the flimsiest of pretenses. Those who could not pay were shot.

fessed believer in her Chinese schooling. "The message has been drilled into us [by the education system] that we can accomplish any goal set before us because nothing compares in difficulty with what they did," she writes.

Over what seems to be several years, Ms. Sun returns to China where she travels the length of the country interviewing over 40 veterans, many of them women, whose candid stories form the basis of her book. A mixture of compassion, humor and tragedy, theirs are the untold stories of ordinary individuals who briefly found something worth fighting—and even dying—for.

Kidnapped into the army as a teenager, the now 86-year-old Soldier Huang recalls the camaraderie of the campaign and the pain of losing many friends. He is also a goldmine for revisionists, explaining how the Red Army kidnapped and ransomed peasants on the flimsiest pretenses of being landlords to secure funds and supplies. Those who could not pay were shot. Another veteran and life-long Party supporter, 93-year-old Wang Quanyuan, describes how female members of her propaganda team were so desperate to fill their recruitment quotas that they offered sex and opium to men who enlisted.

In Gansu Province, Ms. Sun meets Li Wenying, a female member of the infamous Western Legion. Sent by Mao to fight a way through to Soviet supply lines, the female soldiers were captured by local warlords, repeatedly raped, and forced into marriages. Later disowned by the Red Army because of the Legion's association with Zhang Guotao, Ms. Li became the victim of political infighting conducted hundreds of miles away. She was called a traitor and deserter for the next 30 years.

The level of desertions was revealing.

Using existing research, Ms. Sun estimates that 30,000 of the original 86,000 Red Army members who set out from the Jiangxi Soviet may have deserted at the first major battle alone. In official accounts, these losses are always attributed to heavy casualty rates inflicted at what veterans tell the author were over-dramatized battle scenes.

None of this ever featured in Ms. Sun's school textbooks. But as fascinating as it is to observe her own personal re-examination of cherished childhood heroes, these accounts do not destroy the idea of the Long March as an historic undertaking.

A moving and timely first-person account from witnesses who will soon succumb to old age, Ms. Sun interlaces her interviews with vivid descriptions of the landscape and conditions that the marchers faced. At one point she visits the Tibetan plateau where thousands died from the cold.

Ms. Sun herself desperately searches for something tangible on which to pin her inspirations, and finds it. She notes, "many good and brave men died or were left behind ... but those who reached the end of the March really were heroic. They endured so much, overcame so much. They were invincible."

B **BRITISH EXPATRIATES** Ed Jocelyn and Andrew McEwen sought to retrace this road to invincibility, becoming the first non-Chinese to recreate the March since Comintern Agent Otto Braun walked with Mao. Their 384-day trek, begun in 2002, makes clear just how tough and grueling the Long March really was. Hiking along valleys, up moun-

tains and through swamps, their respect for the original marchers is renewed. Mr. McEwen spends much of his time fighting a stomach illness which forces him to briefly return to Beijing.

Like the Red Army before them, these two adventurers often rely heavily upon the goodwill of the villagers they met, with the occasional cool reception by officious security officers, surly waitresses, or “hulooing” layabouts testing their increasingly frayed tempers. Thankfully for all, Messrs. Jocelyn and McEwen exhibit greater tolerance than their vanguard, as the Red Army was not averse to torching villages that were anything less than welcoming.

Writing for a novice audience, seasoned China followers may find little in this text that is new. It certainly does not offer the personal insights of Ms. Sun’s book. But the two explorers do unearth a few historical gems, including an elderly woman who claims to be the long-lost daughter of Mao. So convincing is her story that the authors later contacted Mao’s relatives, who have sent a representative from Beijing to investigate. The representative’s findings remain unknown.

The authors conclude that the Long March was about half the length claimed by Mao—a revelation that brought them a stinging rebuke from the Chinese media. But they also fire off a broadside of their own at the tenuous claims of Jung Chang’s book *Mao: The Unknown Story*. Criticizing it for denying some of the battle scenes that they themselves find witnesses to, Messrs. Jocelyn and McEwen complain that while “it has always been obvious that Mao and his followers twisted the tale of the Long March for their own ends ... it’s equally nonsense to throw the baby out with the bathwater. Whatever use Mao made of it for personal glory and propaganda, the Long March still stands as one of the most epic and important stories of the 20th century.”

THE GIRL

by Sonia Faleiro

Penguin Books India, 136 pages, 9.99

Reviewed by MITALI SARAN

THE NOVELLA IS a slippery literary category. It has its roots in the Renaissance and flowers in every major literary tradition in the world. Yet, like most things that refuse to conform, it remains the object of controversy and a sometimes irritable curiosity. What is it? When does a short story become a novella? When does a novella become a novel? Is it even a question of word count? What about character? What about scope?

All this hoo-ha about the novella is merely a preamble to the view that the debut work of fiction by Indian journalist and blogger Sonia Faleiro is, despite the dust jacket that calls it her first novel, in fact a novella. It’s important to establish that because, evaluated as a novel, *The Girl* might be dismissed as a slight work. There are markers, however, that peg it as a different literary form: It weighs in at 124 smallish pages, turns on one or two incidents rather than on a plot, and focuses fiercely on the inner lives of three characters (but really one) in a forgotten backwater of Goa. It is, in the earliest sense of the word novella, a tale of country life that bears repeating. And by those lights, it is an accomplished work.

From start to finish the protagonist of *The Girl* remains nameless, and for the most part unseen even by the authorial eye. It’s part of her problem—she’s dying, literally, of loneliness. (Spoiler warning, the rest of this paragraph gives away some plot details.) Between February and April the Girl lost her beloved mother in a car crash, watched her grandmother die in the mater-

Ms. Saran is a free-lance writer who lives in Delhi.

Here is an exquisite exploration of suicide, a haunting rendering of pain so acute that it sets your teeth on edge.

nal home on Rua de Amelia Barreto in the town of Salgado, and looked on as her nasty uncle forcibly shipped his frail father off to an old age home so that he could sell the house to a builder without any reference to his niece's future. Her sense of family destroyed, the Girl stands outside the house as it falls to the builder's blows, holding a knapsack and three plastic bags. Then she turns, walks to the bus stand, and buys a ticket to Azul, the place where one can forget and be forgotten. There she falls in love with the tall American "professional traveler" Luke; their story unfolds partly in the Girl's words through her diary, and partly through Luke, who returns to Azul to suffer his own private and public horror.

The Girl comes to live and grieve in house No. 32 in Azul because grief and *Thanatos* is the cultural inheritance of this fishing village by the sea, inhabited by others deadened by loss, rustling with the tragic tales of those who could not bear loss. To observe that Azul is named after the Portuguese word for "blue" might sound flip-pant, but there is nothing flippant about the creepy quality of a place where, under the skin of daily life with pão and Sunday mass, everyone suffers, and the skies weep for six months of the year.

If it all sounds very Garcia Marquez, it is and it isn't. Faleiro's "Village of the Dead" may be a magical-realist magnet for the iron filings of sadness, but she also breathes very authentically Goan life into a community, with a pretty priest, the formidable Mama Lola and her loyal, love-struck son Simon (boss of a store and one-table café), lace-covered old women, and the particular flavor of small-town Goa. Her rendering of the Girl's inner life is only too accurately human and real. She brings to the book a literary voice that has

taken the measure of the most extreme human emotions—love, rage and grief—and, too, of what lies beyond: the desire for blessed release.

Of the physical Girl we know only that she is thin and that her eyes are of two different colors; beyond that, the only description is as she sees herself mirrored in grief, a grotesque distortion. Her wispy corporality literalizes her desire to shed life; the overwhelming mood in these pages is of an existential weariness that wants only to shut its eyes and cease, to leave behind an inescapable horror: "It seemed her eyes could only see those who carried the stamp of the forgotten, the unwanted, the left behind." And in sowing that desire, others who love her reap their own suffering. Luke writes, "I wished her to be tangible proof that people can survive tragedy and emerge the bolder yet the gentler from it." For a while, it looks as if she might recover, albeit with scars, but then Luke makes the mistake of his life—and hers. "The Girl was our hope. The collective hope of all those in Azul who knew her or wanted to be her. But hope dies."

Sonia Faleiro's novella may or may not put one in mind of another, *The Wide Sargasso Sea*. Either way, hers is an exquisite exploration of suicide, a haunting rendering of pain so acute that it sets your teeth on edge. It isn't perfect; its high lyricism occasionally lapses into purple prose, and it omits some details that wouldn't be out of place (what of the Girl's father? How does she come to own No. 32?). But it has wisdom, tenderness, and a sort of agelessness that sets it apart from much other contemporary fiction in English coming out of India. Faleiro is already known for her fine journalism; she shows promise as a writer of fiction.

**PATROLLING THE REVOLUTION:
WORKER MILITIAS, CITIZENSHIP, AND
THE MODERN CHINESE STATE**

by Elizabeth J. Perry

Rowman & Littlefield Publishers, 352
pages, \$39.95

Reviewed by ILARIA MARIA SALA

WITH AN APPROACH at once part historian, part political scientist, Elizabeth Perry looks at the role played by popular Chinese militias in shaping revolutionary political forces, beginning with the armed uprisings of 1920s Shanghai. Her interest piqued while researching her 1993 work on Chinese labor, *Shanghai on Strike*, Ms. Perry has followed with a book rich in details.

Worker and peasant militias, Ms. Perry observes, have been a potent though often unpredictable tool of mass mobilization. She writes: "As an institution charged with patrolling the revolutionary ranks, citizens' militias embody the particular principles of inclusion and exclusion upon which alternative revolutionary edifices are constructed. But militias are seldom docile tools of the regime," she continues, explaining that "by putting weapons in the hands of ordinary citizens, militias create a powerful source of potential opposition to state control."

Ms. Perry recounts how, during the civil war and KMT era, what had started as an Industry Defense Corps—or "workers' militia," officially responsible for keeping order—soon devolved into uncontrollable armed gangs. Some of these militias went on to engage in state terrorism; some turned against other, Communist-organized militias, including those that had similar objectives of protecting factories during pickets by workers.

Ms. Sala is a free-lance writer based in Hong Kong.

This illustrates what Ms. Perry calls the "chameleonic character" of militias in the opening years of the People's Republic, going from revolutionary zealotry to supporting state-building and the Party's consolidation of power.

For many proletarians, Mao's "Everyone's a Soldier" campaign, promoting a universal military mobilization, offered the chance of a "meteoric ascent." Here, Ms. Perry takes the case of Gang of Four member Wang Hongwen, a former cotton-mill worker "rising from obscurity to rank above everyone but Mao Zedong and Zhou Enlai in the leadership hierarchy" thanks to the upheaval of the Cultural Revolution. As Ms. Perry illustrates with her trademark eye for detail and historic poignancy, "the institutional inversion of the Cultural Revolution, which invited workers to 'kick aside' state-sponsored organizations in favor of their own militant alternatives, offered a welcome opportunity for those with political ambitions." Those with political ambitions appear to have been a great many indeed.

More recently, Ms. Perry points to the unauthorized pickets during the 1989 demonstrations as evidence that, to this day, "ordinary citizens have not forgotten the subversive potential of militias." The recent workers' pickets to protect factories against threat of bankruptcy are another such example. Conscious imitations of the revolutionary spirit, "this time their actions are directed against the Communist Party-state."

The unresolved issue underlying the unpredictable potency of popular militias, then and now, according to Ms. Perry, remains a question of citizenship and whether the revolution was fought in the name of a determined class (given the lack of a sufficiently large working class in an overwhelmingly rural country) or an elusive concept of community (often, but not exclusively, determined by geography).

Recent workers' pickets to protect factories against bankruptcy imitate the spirit of revolutionary militias.

In the Maoist era, the question was asked in terms of who should qualify as bona fide members of the proletariat. But even after Deng Xiaoping decided that class struggle could finally be put aside, the lack of popular representation in government has left this problem unresolved, enforcing Ms. Perry's argument that the Chinese revolution has not created a strong identifier for citizenship.

Militias also provide an illuminating point of comparison between regimes, and it is in this exercise that Ms. Perry's work adds its greatest value. In both France and America, post-revolution militias have been built from a foundation of community-based citizenship, and as such, were no obstacles to state-building.

In the case of China and Russia, by contrast, the militias were part of the larger class-overturning project, which meant a much greater reliance on secrecy, conspiracy and infiltration. Still, as Ms. Perry shows, the two experiences developed very differently: In China, the militias were put under the direct control of the People's Liberation Army (which never mastered complete control of these armed citizens) after having been part of the rural Soviets and Mao's "Everyone's a Soldier" campaign. In the Soviet Union, the

militias became part of the police, were rendered ineffective by the application of bureaucratic control, and eventually demobilized.

Ms. Perry then enlarges her comparative perspective to Iran, and to the consequences of a "creed-based citizenship," by looking at the structure and uses of the Iranian Revolutionary Guard (Pasdaran). Created in 1979 by decree of the Ayatollah Khomeini, it went, in a short span of time, from being a disorganized and small formation to a 350,000-strong force of religious zealots, which have become one of Iran's most enduring and powerful revolutionary institutions. Their creed-based fanaticism, is compared to that of the Red Guards during the Cultural Revolution at the height of Mao's personality cult.

The final conclusion Ms. Perry reaches leaves the reader slightly apprehensive, if dreamy with the scope of possibilities: "To revisit a country's revolutionary trajectory, then," she writes, "is not an excuse to surrender to the inevitable oppression of the modern state, but rather an invitation to rethink, rework, and perhaps even reclaim the promises of revolutionary citizenship." Applied, as it is in her book, to all countries formed out of a revolution, this is a proposition surprisingly full of hope. ■

THE REVIEW LIST OF THE BEST ASIAN MYSTERY NOVELS

A TRULY GREAT WHODUNNIT not only adds to the pleasure of relaxing on the beach, it leaves the reader with an insight into a social milieu. And Asia provides plenty of fascinating backdrops against which to stage the perfect murder. Often thought of as a Western invention, in fact the police procedural has Asian precursors, as Robert van Gulik showed by mining a 13th century Chinese manual of jurisprudence and detection for ideas. So settle back in your lounge chair, don't forget the sun tan lotion, and enjoy!

THE CHINESE GOLD MURDERS

by Robert van Gulik
Harper, 224 pages, \$12.95

VAN GULIK WAS a Dutch diplomat and scholar with extraordinarily eclectic interests, among them Chinese detective stories. In 1959, he published this first in a series of 22 novels and stories loosely based on the career of a real Chinese magistrate and folk hero, Dee Jen-djieh, who lived from 630-700. The character development isn't up to much, but the plots are well constructed and sprinkle in devices and cultural details from classical Chinese texts. The author drew the illustrations, which are slightly naughty and evocative of Ming dynasty erotic prints—van Gulik authored a monograph on such prints as well as a groundbreaking work on Chinese sexuality.

DEATH OF A RED HEROINE

by Qiu Xiaolong
Soho, 464 pages, \$14

IN 1990 SHANGHAI, society is in flux, and inspector Chen Cao must traverse a political minefield as he investigates the murder of a model worker. This is the first and best of a series of three (soon to be four) novels featuring Chen. The protagonist, like the author, is a poet, and the action is interspersed with well-chosen references to ancient and modern literature. Robert Hegel writes, "His Inspector Chen is a thoroughly engaging character, the crimes he addresses (and the bureaucratic obstacles he encounters) are remarkably vivid."

PLAYING FOR THRILLS

by Wang Shuo
*Penguin, 336 pages,
 available from abebooks.com from \$2.77*

WANG SHUO IS the bad boy of Chinese letters, a founder of *pizi wenxue*—hooligan literature—and veteran of numerous "pen

wars" with other writers. His stories have become the basis of countless movies and television series (*Playing for Thrills* inspired the 2003 Hollywood film *Love the Hard Way*). Here is a ticket into a world of nihilist youths jaded with their own rebellion. The mystery is highly meta and the plot deliberately confusing, as the antihero struggles to figure out whether he is guilty of the murder of his friend 10 years earlier.

JADE LADY BURNING

by Martin Limón
Soho, 224 pages, \$13

DAVID BARNES WRITES of this Seoul thriller, "It is a gritty story involving U.S. military detectives and a host of underworld figures that thrived on the fringe of the U.S. Army base. I lived a few blocks from where most of the story takes place for five years (2000-2004) and several of the GI dives Limón describes so well still smelled like warm beer. I recommend the book because it paints a verbal picture of a Seoul that is gone ... and of the Korean people that remain, a society still recovering from two generations of subjugation and a brutal civil war." *Slicky Boys* is a worthy sequel.

BANGKOK 8

by John Burdett
Vintage, 336 pages, \$13.95

ROYAL THAI POLICE detective Sonchai Jitpleecheep of Bangkok's District 8 is something of an outsider—the son of a bar girl and an American soldier, he refuses to take kick-backs. In order to avenge his murdered partner, he agrees to team up with a woman FBI agent. Sound clichéd? Hardly. Written by a former lawyer based in Hong Kong, *Bangkok 8* turns the conventions of the hard-boiled novel inside out. Sadly, the follow-up *Bangkok Tattoo* couldn't sustain the energy of this plunge into Thailand's demimonde.

OUT

by Natsuo Kirino
Vintage, 416 pages, \$12.95

JESPER KOLL OF Tokyo writes, "Ever wanted an insight in the dark side of the new Japan? Ever wondered how powerful Japanese women can be? *Out* shows a possible reality of inner feelings and fears empowered against the backdrop of Japan's straightjacket society. The really scary thing is that by the end of the story you begin to fear that there may be nothing uniquely Japanese to the actions and plot, it could happen anywhere."

INSPECTOR IMANISHI INVESTIGATES

by Seicho Matsumoto
Soho, 313 pages, \$13

JAPANESE MASTER OF the genre Seicho Matsumoto never quite topped this 1961 police procedural following Inspector Imanishi—part weary family man, part tenacious detective. The case of a dead body at Tokyo's Kamada station starts out routinely enough, but the corpse's lack of identity pushes the inspector into the darkest and most open-ended investigation of his career. He crosses Tokyo, Osaka, and the still war-ravaged countryside of the early

1960s to solve a murder as complex as the entirety of recently post-war Japan.

THE SKULL MANTRA

by Eliot Pattison
St. Martin's, 448 pages, \$6.99

FORMER POLICE INSPECTOR Shan Tao Yun is under pressure to solve the case of a corpse that turns up on a Tibetan cliff with no head. Problem is, he himself is a convict in China's gulag, sentenced to hard labor in the 404th Construction Brigade. The Chinese government may be trying to destroy Tibetan culture, but its power and resilience become apparent to Shan and the reader.

MOGHUL BUFFET

by Cheryl Benard
Soho, 272 pages, \$12

WHO WOULD HAVE thought a first-time American author could carry off a satirical detective novel set in Peshawar? Yet Cheryl Benard, political analyst and wife of U.S. diplomat Zalmay Khalilzad, creates a distinctive authorial voice that skewers the hypocrisy of Pakistani society while keeping the reader hooked on learning the next revelation.

RUNNERS-UP

Ashes by Kenzo Kitakata
Dragon Bones by Lisa See
Rashomon Gate by I.J. Parker
Reflecting the Sky by S.J. Rozan

The Informer by Akimitsu Takagi
Left in the Care of by Dinah Kung
Black Lotus by Laura Joh Rowland
All She Was Worth by Miyuki Miyabe

Season of the Monsoon by Paul Mann
The Perfect Murder by H.R.F. Keating
The Inugami Clan by Seishi Yokomizo
The Coroner's Lunch by Colin Cotterill
The Salaryman's Wife by Sujata Massey
Yellowthread Street by William Marshall
The Togakushi Legend Murders by Yasuo Uchida
The Complete Adventures of Feluda by Satyajit Ray
The Black Lizard and Beast in the Shadows by Edogawa Rampo

EAST TIMOR BIRTH PAINS

by Bertil Lintner

Vol. 164 No. 35, Sept. 6, 2001, Page 22

EAST TIMOR HAS taken a major step towards formal independence with this week's elections for a constituent assembly, but freedom at last from foreign rule won't solve the territory's myriad problems any time soon. Dili was one big party venue in the run-up to the polls, but the festive air masked the former Portuguese colony's deep political divisions and debilitating poverty after more than two decades of brutal Indonesian rule.

And while top officials of the two-year-old United Nations Transitional Administration in East Timor have hailed the peace process and transition to democracy since the bloodshed that followed the August 1999 vote in favour of independence, they and other foreign observers in Dili believe there is only one person capable of keeping the territory together.

That man, independence-struggle hero Xanana Gusmao, was not among the candidates from 16 political parties vying for the 88 seats in the de facto parliament, which will draft the constitution for independent East Timor.

But he ended months of speculation on Aug. 25 by announcing that, partly due to foreign pressure, he would be running for the presidency. Mr. Gusmao had quit the territory's interim parliament in April saying internal squabbling hampered the territory's transition to independence.

His challengers are likely to include ex-

colleagues in the resistance movement, Fretilin, such as Francisco Xavier do Amaral. But the presidential election, expected next year, will likely be a breeze compared to the hurdles he would face as leader.

For starters, his new nation will rank among the most backward countries in the world. According to U.N. data, per capita GDP is estimated at a mere \$304. Half the population lives below the absolute poverty line of \$1 a day, urban unemployment stands at 80%, slightly more than 50% of the population is illiterate and life expectancy is just 57 years.

Meanwhile, the destruction carried out by pro-Indonesian Timorese militia two years ago has left most of the territory's infrastructure in ruins. A gloomy U.N. report has concluded it will take "sustained growth rates over at least 5 to 6 years to regain the already low pre-crisis income levels."

Not even a recently forged treaty with Australia on sharing fossil-fuel revenues is a guarantee for fiscal self-sufficiency. Dili will receive 90% of the revenues from the production of oil and gas in the Timor Sea, which could bring in as much as \$4 billion to \$5 billion over a 20-year period. But disagreement over how much foreign companies would have to pay in tax could delay the project, which is not expected to come on stream before 2004.

East Timor's problems are further compounded by internal divisions. Despite its tiny size and small population, the territory has at least 12 distinct ethnic groups. The quarter-century Indonesian occupation may have galvanized the East Timorese into resistance and developed a sense of nationhood. But with the common foe gone, old divisions and rivalries based

∞ Mr. Lintner is a Thailand-based journalist.

*With the common foe gone, old divisions and rivalries
based on family and ethnic lines are returning.*

on family and ethnic lines are returning.

And, as one U.N. election observer in Dili pointed out this week, personal differences and old allegiances, not ideology, emerged as main factors dividing the 16 political parties that ran in the poll. The likely main victor, Fretilin, is itself wracked by splits and defections since 1999.

Campaigning was violence-free, but observers noted ominous undercurrents of violence. Many of the smaller parties complained about Fretilin intimidation, while the U.N.-initiated Media Mediation Panel issued a report on Aug. 20 that noted "a disturbing pattern of apparent verbal intimidation."

The threat of future violence comes not only from within but also from Indonesian-controlled West Timor, where pro-Jakarta militias from East Timor are based. U.N. Secretary General Kofi Annan has warned that an international force will be needed in East Timor long after independence—quite an irony after the years of Portuguese and Indonesian rule.

Mr. Gusmao may yet come to rue the day he changed his mind about running for president.

STILL REBELS

by Mark Dodd

Vol. 165 No. 26, July 4, 2002, Page 20

AT JUST FOUR weeks old East Timor may be the world's newest nation, but its first big problem is how to deal with its past. Tensions over the treatment of veteran guerrillas who fought for its independence are challenging the authority of the country's new

democratic government.

In demonstrations across East Timor, hundreds of uniformed men, many armed with knives and machetes and all claiming to be former members of the East Timorese resistance, have been demanding state welfare and official recognition for services rendered during 24 years of armed struggle against Indonesian rule.

The demonstrations were organized by Cornelio Gama, a dissident ex-guerrilla commander who goes by his old jungle code-name, L-7. Mr. Gama claims he has more than 5,000 supporters in a country of 800,000 people.

Their sense of entitlement is compounded by the fact that the new government is led by someone who was once among their ranks: President Xanana Gusmao, the former commander-in-chief of Falintil, which was the armed wing of pro-independence group Fretilin.

Mr. Gama and his supporters are angry at what they claim was a lack of transparency in the selection process that transformed certain former Falintil officers into senior commanders of the national army, the East Timor Defence Force, or FDTL. "It was a political demobilization. Xanana's friends got in and his enemies were left out. It's a politicized military. They are very much Xanana's boys," says a Western security analyst based in Dili.

Three groups, including Mr. Gama's—mischievously named Falintil—claim to represent former combatants and their families. Their noisy martial parades began in the lead-up to independence on May 20, and for many residents of the capital, Dili, they drew a scary parallel with the ugly pro-Jakarta militia rallies of 1999, a time of violence that left an estimated 1,500 people dead. ■

∞ *Mr. Dodd is now the foreign affairs and defense writer for the Australian newspaper.*

The Gimlet Eye



HARRY HARRISON

travellers' TALES

"Job" Listing

CHINA'S SEXUAL REVOLUTION continues apace. A recent edition of Xianzai Shanghai, a kind of online expat newsletter, includes the following job listing: "An Asian adult films company that produces Taiwan/Jap porno films is seeking new talents. If you are an adventurous, pretty and petite girl between 18 to 30 years old, this may be your chance to fame & fortune."

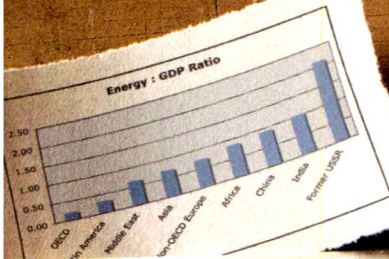
Such an announcement is remarkable to those who remember that just a decade or so ago, young married Chinese were still going to the doctor complaining that they couldn't become pregnant, only to discover that the problem was they didn't know how to have sex. Now there seems to be a sex-toy shop on every corner of Shanghai, and de facto polygamy is making a speedy return. Regarding sex it seems that nations, like individuals, have a tough time finding a happy medium.

Her Majesty's a Pretty Nice Girl

LAST MONTH'S BIRTHDAY reception for Her Majesty Queen Elizabeth II in Hong Kong attracted a few members of the former colony's elite—the ones whose ambitions are so sated they don't care who knows they are still friendly toward the Brits, and those whose China-toadying credentials are so impeccable they can afford to be magnanimous toward the former rulers.

The government reps at the party included the secretary for justice—a lawyer who was plucked from obscurity because of his family connections to Beijing and whose name we can never remember—and Stephen Lam, defender of Hong Kong from the perils of democracy (a post formally known as secretary for constitutional affairs).

Contributions to Travellers' Tales can be emailed to tales@feer.com. Read more Travellers' Tales online at www.feer.com/tales.



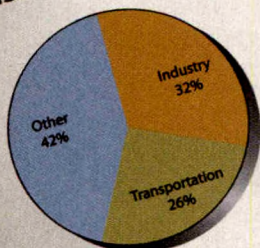
Because of surging economies in the developing world and continued growth among the industrialized nations, global energy use is climbing. As a result, supplies are tight. Prices are rising. And energy users are calling for viable alternatives.

The good news is we've got a huge source of alternative energy all around us. It's called conservation, and it's the lowest cost new source of energy we have at hand. A reduction of just 5% of global energy use would save us the equivalent of over 10 million barrels of oil a day. Clearly, saving energy is like finding it. So how do we do it?

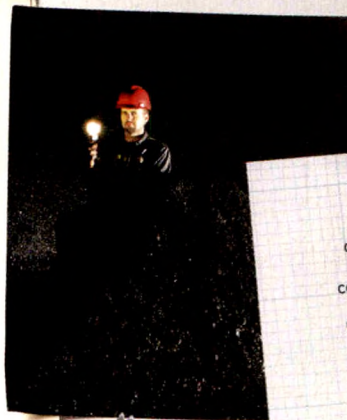
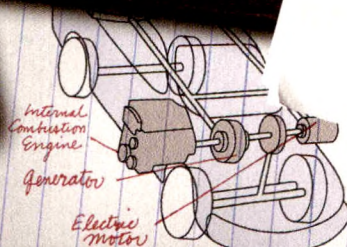
For developed and emerging economies alike, incorporating energy efficient technology into new construction could reduce consumption by 40%. Governments and businesses must reduce their own energy use and promote conservation to their citizens and employees. Further improvements in fuel efficiency will play a crucial role, too. And the average person wields incredible power when it comes to conserving energy, from driving slower to switching to more efficient home appliances.

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- Improvements that will lower a regional postal service's electricity spending by 46%
 - Helping the U.S. government save taxpayers \$151 million while reducing greenhouse gas emissions by an expected 1.5 million tons



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45 MACAU'S HAND FLUSH WITH DISCORD



Zach Coleman, an assistant news editor at the Financial Times in Hong Kong, goes behind the glitzy facade of Macau's casino economy and exposes the discontent among the workers left behind by the boom.

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All articles submitted to the FAR EASTERN ECONOMIC REVIEW must be exclusive to the REVIEW. We prefer that the submission be between 2,000 and 5,000 words, with a cover letter giving a brief summary of your article along with the author's fax number, day and evening phone numbers, mailing address and email addresses. All articles should be sent by email to hugo.restall@feer.com.

AS HAS BEEN widely reported, in August the Singapore government announced it would require the REVIEW and several other foreign publications to put down a deposit and appoint a legal representative in the country if we wish to continue circulating there. The measure, the Ministry of Information, Culture and the Arts says, “serves to reinforce the government’s consistent position that it is a privilege, and not a right, for foreign newspapers to circulate in Singapore.”

This matter has yet to be resolved, and we hope that the Singaporean authorities will reconsider their decision. Whatever they decide, we will continue to publish well-reasoned analysis of the country free of fear or favor. More on this in our next issue.

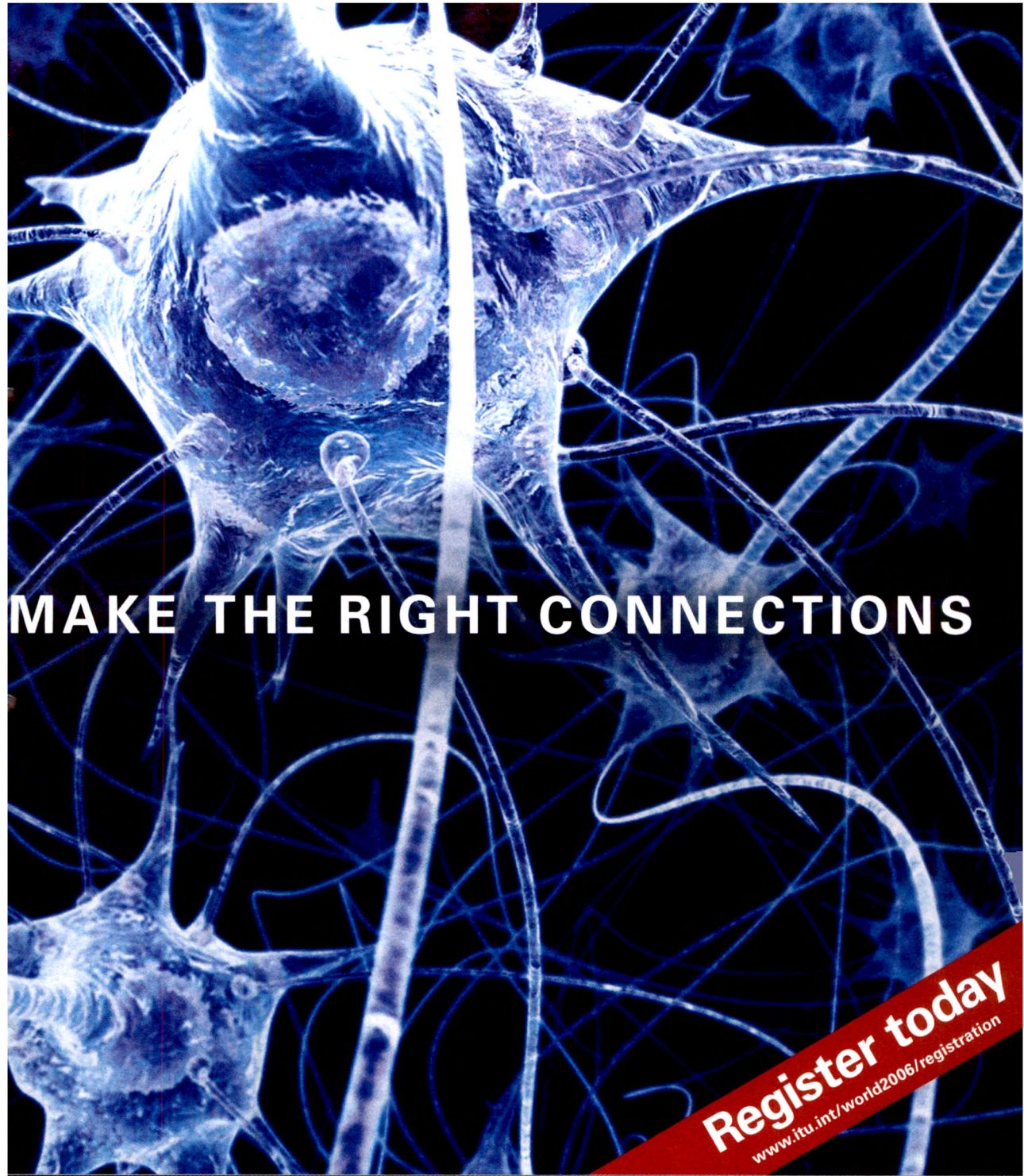
The current issue marks a small milestone, as we tweak several aspects of the magazine’s design. The use of a slightly tighter line spacing in the essays section along with a modest number of color illustrations we hope will enhance the reading experience without sacrificing space for our contributors’ arguments. This will also accommodate advertisers who want the option of color positions on the inside of the magazine. The ethos of the magazine, placing the highest emphasis on the content of the magazine and satisfying the needs of the serious reader, remains unchanged. As always, we welcome your feedback.

Several pieces in this issue address the perennial question of how to read China’s high growth rates. The debate rages simultaneously at different levels. Starting with the most superficial, there are those like Andrew Ross, author of the book *Fast Boat to China* reviewed on page 62, who look at the success of a new industrial heartland and conclude that the country has unfairly tilted the playing field of global trade.

More seriously, there is the question of whether this kind of supercharged growth is healthy and sustainable, both for China and the world. Given ample capital and labor, massive increases in investment do not in themselves mean overheating. As Jonathan Anderson of UBS writes in our lead essay, China’s rise is not so remarkable when one considers its high savings rate, which has propelled the rapid development of other East Asian economies. This macro story will persist.

But the hiccups along the way could be huge, and China needs good advice in order to avoid them. That’s why it is alarming to see the World Bank peddling a Panglossian view of corporate profits and bank lending. As Weijian Shan shows by analyzing the official statistics in greater detail, the reality is much more complex, and troubling.

H.R.



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LETTERS

More Haste, Less Speed

MY REGARDS TO Mr. Ellis and Ms. Gadiesh (“Outsmarting China’s Start-Arounds,” July/Aug 2006). Their idea—that through building, borrowing and buying, Japanese and South Korean companies became global leaders—is very interesting.

However, having done my own research on Lenovo and Shanghai Automotive, I am not convinced that “China is compressing the three distinct phases of building, borrowing and buying into one push.” Chinese companies might be quicker through the learning curve, benefiting from the experiences of their Japanese and South Korean counterparts. But simply squeezing those three phases into one neither guarantees success nor shortens the process.

As the saying goes: “More haste, less speed.” I too am confident that we will witness the emergence of more and more global players from China—but gradually, not at a surprisingly fast pace.

Jiong Zhuang
Shanghai

Broken Promises

BENJAMIN ROBERTSON (“China’s New Education System,” July/August 2006) announced as “good news” a March 2006 government pledge that education spending would reach 4% of GDP over the next

five years. There is nothing new about that promise. It was first made in 1993, and from figures also cited by Mr. Robertson, education spending in 2000 remained at 2.1%. Thirteen years after the original commitment, China maintains a solid record of making and breaking that same promise. It would require a splendid defiance of China’s track record to believe making the same old promise yet again is good news.

Katarina Tomasevski
Copenhagen

Singapore’s Shame

IT IS NOT surprising to learn that the Singapore government has enforced new rules on your respected publication and others for the “privilege” of circulating in the city-state. The reasons behind these new requirements, including paying a security deposit and the appointment of a legal representative in Singapore, are obvious. It is done to silence you and all the other media, preventing reporting on any matters that the Singaporean leaders regard as undesirable.

The Singapore leadership’s libel suits against the leading publications of the world are legendary and make the idea of free, responsible reporting a joke. Hasn’t the time arrived for the media world to come together and fight back? The publications named, most of which have had to pay fines or live with restricted circulation, are owned by the most respected media houses in the world. If all of them were not available on newsstands in Singapore, I have no doubt who would lose out most.

Gary Kitching
Hong Kong

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China's True Growth: No Myth or Miracle

by Jonathan Anderson

IF YOU WANT to know what the world thinks about China's economy, best keep track of what the typical international corporate executive is reading. For the past year or two he has been reading some very provocative books about the mainland business climate. Four in particular top the current "best-seller" list: *The China Dream* by Joe Studwell (second edition reissue), *Mr. China* by Tim Clissold, *China Inc.* by Ted Fishman and *China Shakes the World* by James Kynge. All four are aimed at the mass market and are very entertaining, but they also have significant things to say about the broad economy: how it works, why it works and what's driving growth.

Anyone deciding to read all four volumes, however, would come away bewildered and confused. Messrs. Studwell and Clissold essentially portray China as a house of sand, presaging the downfall of a bubble economy that has propped itself up through a potent cocktail of free capital and distorted resource allocation. Meanwhile, Messrs. Fishman and Kynge show an unprecedented, world-beating dragon,

a success story that is changing the world in myriad ways.

How to explain the difference? It helps to remember the timing. The first two books deal with the events of the mid- to late-1990s, when China was reeling from a sharp economic slowdown: profits were collapsing, the government was putting millions of state workers out of jobs, and cynicism was widespread. The other two are focused on recent trends, essentially written at the top of the cycle: enormous growth, a massive export boom and seemingly unstoppable momentum.

There is, however, one overarching theme that comes screaming through in all four books—and indeed, from almost everything we read today: Whether success or failure, boom or bust, China is the story. Completely *sui generis* in scale and scope, different from everything that came before, the most dramatic event of the century, China "matters" in a way that no other emerging market has.

But what if this turned out not to be

Mr. Anderson is chief Asian economist at UBS.

true? What if China were, in fact, little different from its neighboring countries, in terms of size, speed and importance? In short, what if China were boring?

This is not a rhetorical question, because from a macroeconomic point of view China's growth dynamic is nowhere close to the unprecedented, world-changing phenomenon that boosters would claim—nor does it look particularly imbalanced or precarious, as the naysayers would have it. In fact, looking back 50 years from now the mainland will probably not be seen as special at all; economic historians will place China as a fairly regular part of a growth chain that began with Japan, filtered down through the Asian tigers and subsequently passed on to the Indian sub-continent.

If this sounds strange, it shouldn't. But then, most of us have probably forgotten what the world felt like a few decades ago when the original Asian growth boom was still in full swing. And many observers, if not most, lack the formal economic background required to dissect the regional growth story and determine what really makes it tick. So before we think about China, or India, we need to step back and revisit the experience of their neighbors.

An Asian Digression

IT'S SAFE TO say that the world had never seen anything even close to the growth statistics coming out of Asia in the second half of the 20th century. Between 1950 and 1980, Japan grew at an average real rate of nearly 8%, more than twice the pace of its industrialized counterparts over the same

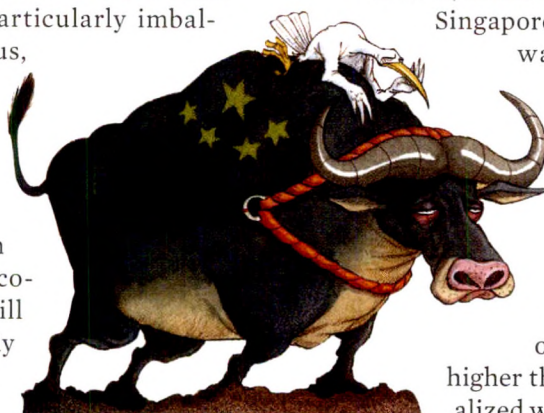
period. In fact, in inflation-adjusted U.S. dollar terms the economy was doubling every six or seven years, an astounding feat by any standard. And this was just the beginning. A few years later an even faster-growing Asian contingent appeared on the scene: From 1960-95, the Hong Kong economy grew at an annualized real pace of 7.7%, South Korea grew at 8.1%,

Singapore at 8.4% and Taiwan at a stunning 8.6%. In Southeast Asia, "quasi-tigers" like Thailand and Malaysia were not far behind.

These growth rates were not only orders of magnitude higher than in the industrialized world, but also much faster than most other de-

veloping economies. By the 1980s, with the world's richer countries in recession and Asia still growing at a near-record pace, the questions began to mount. Had Asia discovered something that the rest of the world had missed? A new way to organize economic activity? In short, was Asia a miracle?

Suddenly, the "Asian growth model" appeared in business-school lecture halls, in academic conferences, and most of all in the popular press, where titles like *Japan as Number One* and *Rising Sun* ruled the day. What was the actual model? On this point most observers differed, but there was a general feeling that whatever Asia was doing, it was somehow better than the atomistic, consumer-driven *laissez-faire* economic culture of the Western democracies. Tight-knit corporations were not beholden to outside shareholders and thus achieved better industrial performance. Traditional Asian values and social cohesion made for a more optimal climate than



HARRY HARRISON

What if China were little different from its neighbors? In short, what if China were boring?

the competitive “me-first” Western model. The main worry was that Asia was consistently outperforming all of its neighbors, and that even in the long term the rest of the world would not be able to keep up.

There were detractors, of course, and for the most part they skewed to the other extreme. Not only was high growth not a miracle, but Asian countries basically got to where they were by cheating. Companies were force-fed cheap capital by state-led banks. Foreigners were not allowed to compete. Exchange rates were hugely undervalued, providing an unfair cost advantage. Governments were mercantilist, suppressing imports and running large surpluses to fund growth. The result may have been resource misallocation on a massive scale, but it didn’t matter as long as U.S. and European consumers were willing to buy up all their products.

It wasn’t until the early 1990s that economists got around to looking at these stories using formal economic tools. What they found blew away both views—and also established one of the most famous findings in modern international economics.

They started with the traditional growth model found in almost every college economics textbook. Stripped of extraneous bells and whistles, the basic formulation offers precisely three ways for an economy to expand: Add more labor, invest more capital, or combine labor and capital in new and better ways, which allows for more growth at every level of physical input. This last element is productivity, or using the proper terminology, “total factor productivity” growth.

Thinking about growth in this way provides a surprisingly easy test of the “Asian model.” If Asia really did create a miracle, in the sense of a fundamentally

new way of doing things, then a large share of the region’s 8%-plus real growth rates would be attributed to total factor productivity expansion. If, on the other hand, governments were forcing superheated growth through heavy-handed, distortive policies, then TFP growth would be negative, a sign that Asia was actually destroying value over time.

Economists had been measuring growth in individual countries for a long time, but with 30 years of statistical data behind them, researchers finally had a chance to test the “Asian growth model” hypothesis across the entire region. One of the first, and the most famous, to do a systematic study of the Asian tiger economies was Alwyn Young. In a series of papers in the early 1990s, he reached two very interesting conclusions.

First, the average rate of total factor productivity growth was decidedly ... well, average. From a productivity perspective, Asia looked exactly the same as the U.S. or EU, with TFP contributing around 1.5 percentage points to total annual growth. Some countries in the region did worse, and some did better, but the overall conclusion was clear: Asia had not discovered a wonderful new growth formula, nor was it any less productive than the developed West. So much for the Asian “miracle.” And so much for Asian “cheating.”

But if productivity wasn’t the main differentiating factor, what did explain the growth gap between Asia and the rest of the world? This was Mr. Young’s second major finding: As it turns out, almost all of Asia’s growth outperformance was due to its extremely high rate of capital creation, more than three times faster than in the U.S. or the EU. Simply put, Asia grew faster because it invested more, full stop.

As you can well imagine, this was a highly controversial conclusion. Instead of finding world-beating new ways to produce, it turns out that Asia's main advantage lay in putting large amounts of capital on the ground (and, to be sure, in finding underemployed rural workers to populate the factories). In Paul Krugman's famous phrase, the region's success came from "perspiration, not inspiration".

Now for the most important question: How did Asia manage to generate so much more investment? And so uniformly across countries? After all, the region was a relatively diverse place: large countries, small city-states, some rich, some poor. Japan and Korea depended heavily on state-led banks and repressive financial polices to channel savings into productive investment. Taiwan and Hong Kong had more liberal economic environments. Political arrangements varied enormously. Yet everyone managed to grow at virtually identical rates.

The answer is that Asia invested more because it saved more. In fact, with the possible exception of a common focus on export markets, a high domestic savings rate was the only common element that tied all the fast-growing Asian economies together. Just look at the chart nearby, which shows historical savings and investment ratios for Japan and the Asian "tigers" compared to the United States.

From 1965-95, the U.S. gross domestic savings rate averaged 18% of GDP, and the U.S. economy invested 17% of GDP over the same period. In high-growth Asia, meanwhile, the average domestic saving ratio was an astonishing 32%—and as a result Asia was able to generate sustainable investment rates of 31%, nearly twice as high as in the developed West.

The bottom line finding was an extremely powerful one. Institutions, organizational models, specific ways of doing business, none of these mattered very much at the end of the day. What did mat-

ter is savings, and the lesson of Asia is that when you have domestic savings rates of 30% of GDP or more, it's awfully hard not to grow at 8%.

And So to China

TURNING TO CHINA, the reason for our long detour should be immediately apparent. Over the past 25 years, the mainland economy recorded an average real growth rate of more than 9.5% per annum, making it the new world record holder among major economies. Does this make China different? Are there unique factors that push the mainland to the head of the pack? Or is this just one more example of an Asian high-growth economy in action?

Most casual observers would respond that China is very different indeed—but the broad bulk of serious research on the mainland economy says they're wrong. Despite China's seemingly world-beating rise and the hype surrounding China's "special circumstances," from a macroeconomic perspective the mainland looks almost exactly like its Asian predecessors.

We know this because over the past 10 years analysts have applied the same decomposition tools to Chinese growth as they did to the rest of Asia. Even if we bring those headline numbers down a notch (most economists assume an average growth rate of perhaps 8.5% to 9% over the past few decades), the Chinese growth story is hauntingly familiar to anyone studying the earlier Asian experience: a reasonable but respectable TFP role, another modest share coming from labor force growth, and an overwhelming contribution from capital investment. As it turns out, the only reason mainland growth has exceeded the rest of Asia is because China saves and invests even more than its neighbors, as you can see from the chart.

Meanwhile, many of the "China specifics" that investors invariably cite turn out

to be common Asian characteristics as well. An artificially low cost of capital? Nothing could be further from the truth. Low interest rates are a classic economic result of Asia's high gross domestic savings rate of 35% to 40% of GDP, especially when you consider that these funds are invariably funneled through overdeveloped banking systems across the region. Chinese real interest rates may look very low by historical emerging market standards, but not by Asian standards; in fact, average rates in China are no different from the four Asian tigers over the past few decades—and much higher than in Japan during its high-growth phase.

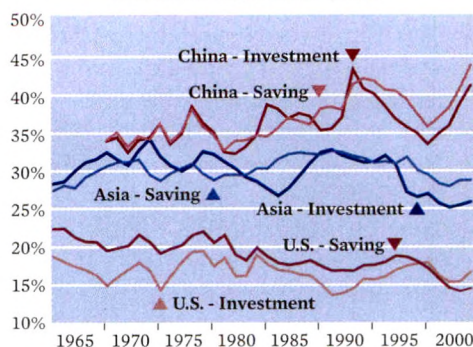
An undervalued yuan? Current account and balance of payments surpluses are yet another natural corollary to high domestic saving rates. Asian countries don't import capital; they export it, and this makes their exchange rates look chronically undervalued even under the best of circumstances. Even China's recent cyclically high current account surpluses are well below the historical peak surpluses in Korea, Taiwan, Hong Kong and Singapore as a share of GDP. And anyone involved with international economics in the 1980s would find today's preoccupation with the level of the yuan eerily similar to the widespread obsession with the yen, the won and the Taiwanese dollar back then.

What about China's planned economy? Surely this is one crucial difference between the mainland and the rest of Asia, as China's socialist, state-led model uniquely forces excessive amounts of capital into unproductive activities, with high growth rates but low social benefit?

Not according to the numbers. Nearly every academic study shows that the TFP contribution to overall growth in China has been slightly higher than the Asian average, which means that China actually has a better productivity record than its neighbors. In part, this is a reflection of

CHINA OUTDOES ASIA AND U.S.

China invests and saves even more than other Asian nations and U.S., in share of GDP.



SOURCE: UBS; ASIA= JAPAN AND ASIAN TIGERS

the rapidly growing private sector; the state accounted for more than two-thirds of the economy 15 years ago, but only one-third today. And in part, it reflects the mainland government's surprising commitment to some core market principles.

Japan and Korea, in particular, have a long history of placing social cohesion above economic rationalization (think of Japanese "zombie" companies in the post-bubble 1990s)—but not China, which when faced with its own sharp downturn in the late 1990s immediately set about shutting down tens of thousands of insolvent firms and making nearly 30 million state workers redundant. Both Japan and Korea also actively discouraged excessive foreign competition throughout their development history—but not China, which last year alone attracted more foreign direct investment than Japan did over the entire last decade.

How can this be, when Chinese companies are notorious for not making money? The answer is that this is an outright myth—Chinese companies do make money, and a good bit of it, over the typical business cycle. What is true is that China's return on capital is relatively low, but this also turns out to be a fairly mundane problem in high-savings Asian economies. If you look at data on corporate return on eq-

uity or return on invested capital across Asia for the past 10 to 20 years, you will find that the best corporate performers are invariably in low-savings countries like India and Indonesia, while Japan and the Asian tigers have markedly lower returns. Why? Because a high pool of savings means low interest rates and capital costs, which in turn pushes up investment rates and drives down returns. When we compare China to the neighbors, its average rate of return is virtually identical to the rest of high-growth Asia.

Size Matters

BUT DOESN'T THIS miss the point completely? After all, the most striking fact about China is not its growth potential, but rather its size; with 1.3 billion people, surely the mainland has a much bigger impact on the global economy than the earlier Asian growth leaders? The answer is that of course China is bigger—but so is the rest of the world. Even when we account for absolute size, we still find that the mainland's dramatic rise has no more of an impact on the developed world than that of its neighbors a few decades ago.

Here are the numbers: From only 4% of global output in 2000, China should account for 11% of world GDP by 2025. Impressive, certainly, but compare this path with Asia's historical performance: In 1965, Japan, the Asian tigers and Asean collectively accounted for exactly 4% of global GDP; 20 years later, in 1985, the share had increased to 13%, and more than 16% by 1990.

On the trade front as well, China's forecasted rise to 12% by 2025 from 4% of glob-

al trade looks little different from the historical performance of its Asian neighbors, which increased their share to 15% by 1990 from 6% in 1960.

How about competitiveness? Is China moving up the value-added chain faster than the rest of Asia? It took Korea and Taiwan 10 years to take over global market share in light manufacturing, another 10 years to develop its electronics industry, and a third decade to switch out of low-end exports into capital-intensive industries. Where does China fit in? Right on schedule. The mainland spent 10 years from 1990 until 2000 taking over low-end markets, and for the last five years has been rapidly gaining

market share in electronics.

The bottom line is that China's growth trend is impressive, but by no means unprecedented. Quite the opposite: Whether we look at GDP, trade or industrialization, the mainland has been treading a path laid out earlier by other Asian economies—and is, at best, simply matching the dynamism of Japan and the Asian tiger economies. Obviously the world faces challenges from a rising China, but it has faced these before.

India, the “Stealth” Tiger

AND IT DOESN'T end with China. If the mainland economy is simply the latest in a long chain of Asian success stories, then it makes sense to assume that more are on the way. In terms of the broad macroeconomic factors above, it's hard to avoid the conclusion that India will soon be joining the fray.

This may sound incredibly optimistic to anyone who's ever been to India, where



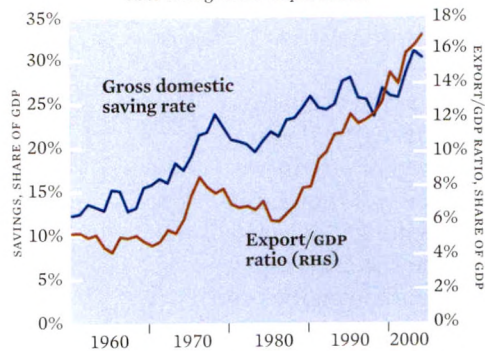
the economy is, if anything, seen as the “anti-China”: highly politicized, fraught with a dysfunctional bureaucracy, overly regulated in every area and fragmented in the extreme. The physical infrastructure is in sorry shape. Economic indicators don’t seem very promising: The budget is in large and chronic deficit, the balance of payments is prone to fragility, and capital costs are significantly higher than in East Asia. In this light, the recent IT services boom looks like a small oasis in a sea of troubles. India has never been able to generate any dynamism in the manufacturing sector, and receives less than one-tenth of the FDI inflows that China does.

But keep your eye on the macroeconomic fundamentals. As we saw above, what really matters is savings, savings and more savings. How does India fare? Twenty years ago, the gross domestic savings rate was well under 20% of GDP, more a Latin American-style laggard than an Asian tiger, and as a result Indian real GDP growth was idling at around 4.5% per annum. However, as the chart nearby shows, over the past decade India’s savings ratio has risen to nearly 30% of GDP, and the trend is still strongly upward. Suddenly the economy is generating 7% real growth or higher—and no longer looks that much different from its East Asian counterparts.

Where will the savings go? Eventually, into export manufacturing. Unlike China, India still has a rapidly growing population, and again unlike China, India has had a difficult time raising agricultural yields and productivity—it does not have anything remotely close to China’s equitable land distribution. This makes it imperative to achieve rapid employment growth outside the rural economy, and despite the celebrated success of the Indian services sector, services are simply not capable of generating hundreds of millions of new jobs. Looking at the Chinese and Asian ex-

INDIA PLAYS CATCH UP

India’s savings rate is on the up while exports take on a greater importance.



SOURCE: UBS

perience, labor-intensive export manufacturing has always been a key destination for savings and the strong initial driver of new income growth.

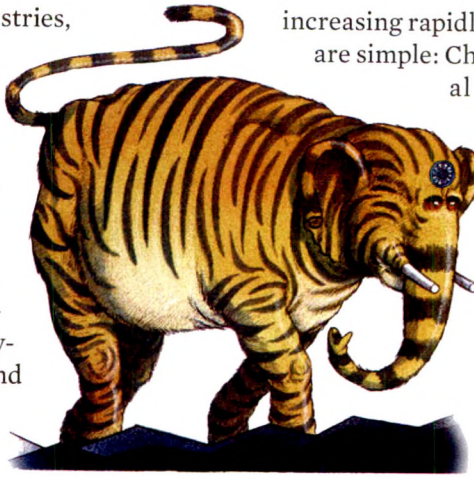
This hardly seems like a reasonable expectation for India. But remember that when China was starting out in the late 1980s, it looked far worse than India does today. The state accounted for most employment in the nonagricultural economy, and labor restrictions were very onerous. There were very few truly private firms, and private capital had no legal protections whatsoever. Inflows of FDI were a paltry \$2 billion per year, much less than in India currently. On paper, the economy was almost completely closed, and the authorities had only a tenuous interest in market-led reforms.

Moreover, when China’s export economy began to develop, it was not led by central policy decisions, nor was it due to the formal easing of economic controls or restrictions. And it didn’t happen nationwide; instead, it happened in one province, Guangdong. In order to take advantage of cheaper labor, Hong Kong manufacturers gradually began opening factories over the border. In order to create jobs, local authorities were more than willing to ignore formal restrictions and provide incentives on the ground. Because of the labor-inten-

sive nature of the industries, the initial dollar amounts of investment were relatively small.

It wasn't until a half-decade later, when other provinces started to replicate Guangdong's successes, that the central government took notice and undertook a more fundamental liberalization of the economy, allowing greater leeway for FDI and export manufacturing on a nationwide basis.

And the most interesting thing in this regard is that from the chart on the previous page, India now looks almost exactly like China did in the early 1990s, with an export-to-GDP ratio of around 15%—and



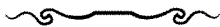
increasing rapidly. The lessons for India are simple: China isn't a dysfunctional outlier. High Indian savings rates are already in place. And it doesn't necessarily take a revolution to get the export story going, sometimes all it takes is a little push.

We even have a likely candidate for that push, as rising mainland unskilled wages are already starting to put pressure on low-end export industries. And as China's costs go up, India could start to look attractive indeed. So keep an eye on the Indian export sector over the next five years—this just might be the catalyst that finally launches the country's career as a tiger. ■



Japan Spirals Into Insecurity

by Robyn Lim



NORTH KOREA'S NUCLEAR and missile brinkmanship risks destabilizing North Asia. This is not only because of the threat posed by Pyongyang's possession of missiles and weapons of mass destruction—although that alone represents a huge concern. More worrying is the prospect that certain circumstances might lead Tokyo to develop its own nuclear weapons in response.

Increasingly in Japan there is talk of a possible pre-emptive strike against North Korea, especially since the July 5 multiple missile launches by the Kim Jong Il regime. Fueling this is a growing fear that the U.S. "nuclear umbrella," combined with the prospect of missile defense, might not be enough to assuage Japan's growing strategic anxieties.

If Japan were to acquire nuclear weapons to ward off the North Korea threat, it would at the same time also be acquiring the ability to deter China. Thus the region could be on the brink of dangerous nuclear confrontations over which the United States would have little influence.

The July 5 missile launches showed

that the threat to Japan has increased substantially since 1993, when North Korea first tested a Nodong medium range missile capable of reaching most parts of Japan. While the July 5 launch of the long-range Taepodong II failed, six Nodong and short-range Scud missiles did not. In fact, these missiles were subsequently assessed as more accurate and thus more dangerous to Japan than previously believed. North Korea apparently has more than two hundred Nodong missiles hidden in caves on mobile launchers. Unlike the long-range missiles, these could be launched with little warning.

Although Japan is faced with a substantially increased North Korean missile and nuclear threat, Japanese leaders know that the U.S. cannot credibly threaten Pyongyang, despite America's immense air and naval power in the Western Pacific. In 2003, the U.S. was able to invade Iraq more or less on the basis of its own re-

Ms. Lim is a professor of international relations at Nanzan University in Nagoya. From 1988-94 she was an analyst for Australia's Office of National Assessments.



A Standard Missile-3 missile defense interceptor is launched from the Aegis cruiser USS Shiloh.

sources, but that is not an option available in relation to North Korea. Unlike Iraq, North Korea could retaliate.

Moreover, Washington cannot afford to ignore China's vital interests on the Korean peninsula. In 1950, America discounted China's strategic imperative to maintain a buffer state south of the Yalu River. That miscalculation led to China's intervention in the Korean War resulting in an ugly ground conflict that ended in stalemate and the loss of 65,000 American lives. The Chinese military still maintains close relations with its counterpart in North Korea. Indeed, there are said to be underground tunnels that allow weapons and other materials to be transported between allies without being detected by U.S. satellite surveillance. In some circumstances, China might still be willing to go to war to preserve the regime in North Korea. With American ground forces overstretched as a consequence of a botched occupation of Iraq, the U.S. cannot afford to discount this possibility.

To make matters worse, Washington has a very wobbly ally in Seoul. South Koreans are especially afraid of the North's forward-deployed artillery and rockets, which could lay down half a million rounds an hour on Seoul. Although South Korea's economy is now at least 20 times that of the North, the South has been unable to translate that economic supremacy into political leverage. South Koreans also fear the economic costs of reunification, and thus most of them prefer to appease the North.

That has certainly been the case under the administration of President Roh Myoo Hyun, elected in late 2001. Mr. Roh's term in office ends in January 2008, and his political fortunes are now at such a low point that it seems likely the conservatives will return to power. Even so, perhaps the rot in the alliance now runs too deep. And as long as the South Korean government's support remains shaky, the U.S. will have no credible means of threatening the government in the North.

The fact that America lacks a credible military option became even more obvious after senior members of the former Clinton administration publicly advocated a pre-emptive attack on North Korea's Musudan-ri launch facility. In an op-ed in *The Washington Post* on June 22, former Secretary of Defense William Perry and Former Assistant Secretary of Defense Ashton Carter said that the U.S. could attack Musudan-ri with submarine-launched cruise missiles loaded with conventional warheads.

Messrs. Perry and Carter were remarkably sanguine about the risks of war. South Koreans, they said, should understand that U.S. territory was now also being threatened, and so America must respond. If North Korea invaded the South, they said, the result would be the certain end of Kim Jong Il's regime "within a few bloody weeks of war." They also claimed that Japan would quietly support a U.S. pre-emptive strike on Musadan-ri.

The Bush administration was quick to disavow the Carter-Perry pre-emptive strike talk. Instead, the U.S. president has preferred to emphasize multilateral diplomacy in the form of the Six Party Talks convened by China. Indeed, China holds most of the keys in relation to the peninsula, and is now the de facto ally of both Koreas.

Yet while relations between Beijing and Pyongyang are friendly on the whole, North Korea is blackmailing even the Chi-

China might still be willing to risk war in order to preserve its troublesome ally in North Korea.

nese. Like the U.S., China is not looking for another war on the Korean peninsula. Indeed, China publicly said it did not want North Korea to test its Taepodong II missile, and wanted North Korea to return to the Six Party Talks. Thus North Korea's launches were as much a slap in the face to China as to all the other interested parties. In the wake of the July missile launches, President Hu Jintao reportedly sent a stiffly worded letter to Kim Jong Il.

China wants North Korea to embark on the path that Deng Xiaoping set China on in 1978 to accept the victory of capitalism over socialism, while retaining Leninist party control. China could then hope to harness South Korean technology to help transform the North Korean economy, while seeking to ensure that any reunification take place on terms set in Beijing. For its part, the U.S. could live with that outcome since it would mean that China would remain strong enough to prevent disagreeable behavior by a reunified Korea. It would be in China's interests to keep the peninsula nonnuclear, lest it trigger a nuclear response from Japan.

But North Korea fears the consequences of opening up and is bent not only on maintaining the regime but ensuring the succession to Kim Jong Il. Thus China has been unable to impose its will, and so North Korea is blackmailing Beijing. It is doing so by holding both economic and strategic critical interests hostage. China, which recognized South Korea in 1992, now has large equities in the South Korean economy as a consequence of its own huge policy change under Deng. Thus a threat to Seoul is also a threat to economic Chinese interests, at a time when China needs constant rapid economic growth to deal with rising problems of social instability.

North Korea also blackmails China because of China's fears of "something worse" on its vital Manchurian frontier. However frustrated China is with North Korea, from China's perspective, all likely alternatives to Kim Jong Il are worse, including regime collapse that could send millions of desperate refugees flooding into Northeast China.

North Korea serves China's interests simply by continuing to exist, so China is willing to supply North Korea with fuel and food and to use its veto in the United Nations Security Council to prevent tough sanctions being imposed on North Korea. And in some circumstances, as noted, China might still be willing to risk war in order to preserve its troublesome ally in North Korea.

Tokyo: On the Defensive

IT IS NOT surprising that the talk of the pre-emptive strike against North Korea in the U.S. following the July missile launches found its echo in Japan. Both the head of Japan's Defense Agency (JDA), Fukushima Nukaga, and Chief Cabinet Secretary Shinzo Abe said that Japan had the right to make pre-emptive strikes against North Korean missiles once it had developed the capability to do so. Currently, Japan lacks the capability to attack anyone. But that would start to change if Japan were to procure land attack versions of antiship missiles that could be launched in the air. Japan has also expressed interest in the recent past in purchasing Tomahawk land attack cruise missiles from the United States.

But Japan's talk of pre-emptive strike evoked a predictably fierce response from South Korea and raised eyebrows elsewhere. So Japanese leaders stopped talking

publicly about pre-emptive options and instead asked the U.S. to help fill the gaps created by Japan's perception of an enhanced threat from North Korea's missiles.

Indeed, Japan—after dragging its feet for years on missile defense—has been galvanized into action by North Korea's latest provocation, as well as increasing indications that Pyongyang might conduct an underground nuclear test. The JDA has now made missile defense a priority and plans to request a record budget allocation of around \$1.9 billion in the fiscal 2007 budget to pay for it. Moreover, for the first time since 1945, Japan has asked the U.S. to beef up its military presence in Japan by sending additional Aegis warships equipped with the SM-3 interceptor missile. (Japan won't have any of its own Aegis warships fitted with SM-3s for another 18 months.) Japan has also asked the U.S. to accelerate the deployment of Patriot Advanced Capability-3 (PAC-3) missile batteries. In addition, the U.S. is reportedly considering the deployment of an additional mobile X-band radar to Japan, to supplement the X-band radar recently installed in northern Honshu. This will give better surveillance of North Korean missile launches.

Yet some important issues remain unresolved between Washington and Tokyo on what is referred to as the "architecture" of missile defense. This will be a critical issue for defining the future of the alliance, since nuclear weapons bring out the bedrock interests of states. Whose finger will be on the trigger, and what will be the rules of engagement? This problem goes beyond issues of interoperability, on which Japan has been delaying action for years.

One of the key impediments is related to the "collective self-defense" issue. Throughout the Cold War, Japan interpreted its "peace" constitution to mean that although Japan had the right to collective self-defense (the right of all mem-

bers of the United Nations), it chose not to exercise that right. This was done in response to a variety of domestic-policy imperatives, not least because it suited most interests in Japan to avoid entanglement in America's wars. Thus, even today, a U.S. aircraft carrier battle group in the Japan Sea, operating in defense of Japan, still cannot communicate in real time with Japanese air defenses. That is very different from standard NATO practice.

One reason that some in Japan are not enthusiastic about promoting seamless interoperability is the power of vested interests—among them Japanese defense contractors—who are pushing the idea of "independent" missile defense. But they have been reluctant to define what they mean by this.

In a visit to Washington in June 2001, then-JDA director Gen Nakatani, told U.S. Secretary of Defense Donald Rumsfeld that missile defense would "be operated by Japan independently." It is noteworthy that in the wake of the 1998 Taepodong I launch, Japan opted to build its own reconnaissance satellites. That strongly suggested an unwillingness to rely completely on the U.S. early warning system.

Mr. Nakatani's remarks were ambiguous. Narrowly interpreted, they could mean "command and control" issues from the perspective of what rules of engagement would apply to Japan's defense force. But Mr. Nakatani's comments could also mean that Japan intended to remain as separate as possible.

This strongly suggests a preference for a missile-defense structure in Japan that would be unacceptable to the U.S. Congress, where there is mounting concern about the huge costs of missile defense at a time when the U.S. defense budget is under great pressure. Moreover, many in Congress regard Japan as a free rider whose contribution to the Iraq war was less than impressive.

Whose finger will be on the trigger—America's or Japan's? And what will be the rules of engagement?

Japan does want protection against North Korean and Chinese missiles. Thus many Japanese do see the need to join a U.S.-led global system. They also understand that building an "independent" system, complete with infrared satellites, sensors and advanced radars, would be horrendously expensive at a time when Japan's finances are still in poor shape. Moreover, another big negative to developing its own missile-defense system independently would be that Japan's neighbors would think that Japan was now slipping its leash, preferring no longer to remain a U.S. strategic dependent. This would come at time when tension with its Asian neighbors runs high thanks to Prime Minister Junichiro Koizumi's annual visits to the controversial Yasukuni Shrine.

Those in Japan who favor an independently developed missile-defense program continue to worry about becoming embroiled in a U.S.-led global alliance that might restrict Japan's freedom of action, not least in relation to China. U.S. and Japanese interests, while congruent with respect to China, are far from identical: U.S. strategic interests are global, while Japan's are much more regionally concentrated.

Thus while North Korea's latest provocations resulted in significant progress in U.S.-Japan cooperation on missile defense, Japan has yet to decide whether to invest in many key aspects of what will be required to make it all work, including a dedicated national command center. Mr. Abe, who is highly likely to succeed Mr. Koizumi as prime minister in late September, has long indicated that he wants to drop Japan's self-imposed ban on collective self-defense. That step, long overdue, would be a vital first step towards creating a seamlessly interoperable system with the U.S.

But it's not just North Korea's provocative behavior that has helped propel Mr. Abe into the top job in Japan. China has also helped out by poking Japan in the eye ever since the Cold War ended. Indeed, Japan's 2006 Defense White Paper, approved by the cabinet on Aug. 1, had much to say about China's growing military capabilities.

While estimates vary, most informed observers believe that the real rate of China's military spending is at least four times the official estimates. That would mean that in 2006, China will spend some \$165 billion—roughly one third of U.S. military spending, and by far the second highest in the world. So China is spending roughly 8% to 9% of GNP on the military, compared to roughly 1% for Japan, and 3.8% for the U.S.

And while Beijing's attention is focused mostly on Taiwan, China's growing capabilities suggest wider ambition—especially China's blue-water ambitions—that no government in Tokyo could afford to ignore. Japan is also watching China's growing missile capabilities, including its long-range ballistic missiles targeting the U.S. and the intermediate range ballistic missiles that can reach Japan. Beijing is also showing interest in the development of supersonic and highly accurate cruise missiles and buying relevant technology from Russia and Ukraine.

Asia's Nuclear Reaction

JAPAN MIGHT INITIALLY hope that if it acquires offensive capabilities, these could remain nonnuclear. Indeed, there are strong domestic antinuclear constituencies, including New Komeito, the coalition partner of the ruling Liberal Democratic

Party. Japan has also been a “model citizen” as far as the Non-Proliferation Treaty regime has been concerned. There is no sign that the LDP is preparing the public to accept the idea that Japan needs nuclear weapons for its security. It is therefore an exaggeration to say that Japan has a “recessed” nuclear capability.

Yet Japan has kept its options open, as indeed it must when it lives in a potentially dangerous region. During the Cold War, the ruling conservatives fobbed off pressure to incorporate nonnuclear principles into the constitution, which is difficult to alter. But if Japan begins to lose confidence that the U.S. would indeed be willing to “risk New York to save Tokyo,” it will be attracted to the idea of acquiring its own offensive capabilities. It seems unlikely that these would remain nonnuclear, because the alternative to “extended deterrence” is not conventional deterrence, as the arms control fraternity like to think. On the contrary, it is nuclear proliferation.

North Korean and Chinese missiles threaten to lead to nuclear proliferation in North Asia. The countries of North Asia are all strong states, and the power balance is brittle. So the risk of war arises not because any of the parties want it. Rather, the risk of war arises for the usual reasons, as a consequence of miscalculation when clashes of strategic interests already exist. Would further nuclear proliferation in North Asia make war more or less likely? We simply don't know.

During the Cold War the existence of

nuclear weapons acted as the greatest constraint on the likelihood of war. Similarly, in the aftermath of the 1998 nuclear tests by both India and Pakistan, the subcontinent seems to have become less dangerous, even though the issue at the heart of the struggle—Kashmir—remains unresolved. Both sides seem to agree that a fourth war is now unlikely. Yet the history of nuclear deterrence since 1945 does not mean that nuclear weapons reduce the risks of a power struggle in all hands, in whatever circumstances. Indeed, it's hard to be sanguine about proliferation in the Middle East, where anarchy is growing.

In relation to North Asia, it is impossible to know what might happen if Japan came to think that it needed nuclear weapons to deter China and North Korea. If Japan developed nuclear weapons, would other U.S. allies, such as Australia, for example, believe they needed nuclear weapons because they do not trust a Japan that has been unable to resolve the issues from World War II on terms acceptable to its neighbors? And if Australia now began to feel it needed nuclear weapons, would Indonesia then also want them?

There is no way of knowing the answers to these questions, but we may be on the cusp of finding out. North Korea maintains the initiative and is reportedly making preparations for an underground nuclear test. Its dangerous nuclear and missile brinkmanship could have far-reaching consequences—the precise nature of which is as yet impossible to predict. ■



A Tug of War for Thailand's Soul

by Colum Murphy



INSIDE THE ENTRANCE to the Thai Rak Thai's party headquarters in Bangkok hangs a giant photograph of Prime Minister Thaksin Shinawatra bowing to King Bhumibol Adulyadej. Dressed in the white uniform sometimes worn by government officials, the prime minister is prostrate before the much-revered king in a gesture of devoted servitude. Yet few in Thailand believe that relations between the two men are as amiable as the photograph suggests.

"He [Mr. Thaksin] has pitched a fight with the Bangkok elite, including the palace—and that means the king himself," says a Western diplomat. Earlier in the year, Mr. Thaksin reportedly said that he would step down if the king "whispered in his ear" to do so. "Well the king has not just whispered it, but has said it indirectly in public," adds the diplomat.

With fresh elections planned for October 15, it could be only a matter of weeks before a major showdown occurs. But more is at stake than Mr. Thaksin's political career. There would be ramifications for the monarchy as well, and its relation-

ship with the country's still-weak democratic institutions. A drawn-out dispute between Mr. Thaksin and the king, also known as Rama IX, threatens to derail efforts to address the challenges to Thai society such as the disparity between the rich and poor, the urban and rural, as well as systemic corruption.

Two Men, One Constituency

IN THE PAST, any discord between the king and the prime minister was kept well hidden, thanks in part to Thailand's severe *lèse majesté* laws, which threaten three to 15 years in prison for anyone considered to have criticized the palace. Even though the king, in his December 2005 birthday speech, declared that he is open to criticism, most Thai and foreign analysts residing in the kingdom still balk at expressing their views on the record.

Yet it is becoming increasingly difficult to ignore the growing tension, some of which is as a result of the April 2 elections fiasco, which was boycotted by the main

Mr. Murphy is deputy editor of the REVIEW.

opposition parties and was later annulled by the country's Constitution Court.

Mr. Thaksin's handling—critics say mishandling—of the unrest in Thailand's predominantly Muslim deep south has frequently been at odds with the king's wishes. The palace's hopes that the crisis could be solved through a "gentle approach" were dashed by Mr. Thaksin's heavy-handed tactics to quell what he considers to be bandit activity. Mr. Thaksin may have agreed to set up a National Reconciliation Commission (headed by Anand Panyarachun, who was ap-

Thailand—the demographic that re-elected Mr. Thaksin and his party in February 2005, when TRT won 19 million, or 61%, of the vote.

While the rural poor are the bulwark of both the king and Mr. Thaksin, a yawning gap exists between the two men's philosophies on how to bring prosperity to the poverty-stricken farmers. For decades the king has been championing rural development through his Buddhist-inspired economics, stressing self-sufficiency and moderation, and encouraging Thais to look more to the domestic economy for growth opportunities rather than on overrelying on export markets or fickle foreign investors.

This could not be more different from Mr. Thaksin's übercapitalist and pro-globalization stance. Mr. Thaksin's schemes to convert the rural poor into enterprising capitalists, for example, do not sit well with the more conservative, pro-monarchy quarters of Thai society who dismiss them as wasteful quick-fixes whose long-term benefits to the poor are questionable to say



HADI FARAHANI

pointed prime minister twice by the king) charged with devising a plan to bring long-term peace to the south, but he also promptly sidelined the body and largely ignored its recommendations.

At the heart of the matter is the fact that the two men draw support from the same bedrock of Thai society. No one could ever doubt the genuine affection the Thai people have for their monarch. Witness the huge outpouring of support in June this year during the 60th anniversary celebrations of King Bhumibol's reign. Nowhere is the love for the king more heartfelt than among the poor of rural

the least. Whether these criticisms are justified or not, his policies have made Mr. Thaksin—the "thunder out of Chiang Mai"—immensely popular.

Thitinan Pongsudhirak, director of the Institute of Security and International Studies at Chulalongkorn University, says that Mr. Thaksin has managed to garner the support of the masses in a matter of four to five years. "The king took four decades of hard work to become so adored and popular."

"I see it as a battle for the hearts and minds of the Thai people," says Mr. Thitinan of the current state of affairs. "The

The king and Mr. Thaksin draw support from the same bedrock of Thai society, namely, the rural poor.

king and Mr. Thaksin have the same constituency.”

Thaksin's Troubles Cascade

THE MOST CONCRETE evidence of tension has emerged since last April's national elections. When Mr. Thaksin called the snap ballot, the main opposition parties promptly boycotted. Led by the People's Alliance for Democracy (PAD), massive street protests were held in Bangkok, drawing marchers mainly from the urban elite and middle class. Mr. Thaksin was accused of abusing the country's political process for personal gain. Protestors called for his expulsion from politics. Nevertheless, Mr. Thaksin held firm, insisting that the elections continue. Running unopposed, it came as no surprise that Mr. Thaksin and his TRT party swept to victory in more than 270 constituencies for the 500-seat House of Representatives. Mr. Thaksin garnered 16 million votes, or 57% of the total.

Perhaps Mr. Thaksin had hoped that an election victory would demonstrate that he—not the street protestors—was the democratically elected voice of the people. However, when on the evening of April 4 the king summoned Mr. Thaksin to the royal palace, it became clear the tycoon-turned-politician was in trouble. To this day, nobody knows what the king told Mr. Thaksin that night, but shortly after the hastily called meeting, Mr. Thaksin proclaimed that he would take a break from politics. The king, it seemed, had successfully reined in Mr. Thaksin. (Still others believe that there was no “whisper in the ear” and that the whole episode was political theater masterminded by Mr. Thaksin.)

In a matter of weeks, however, Mr.

Thaksin jumped back into politics, albeit with the title of “caretaker” prime minister. Soon he was making official overseas trips and reportedly dashing off secret letters to foreign leaders, including U.S. President George W. Bush, complaining that he was being targeted by undemocratic forces.

It's possible Mr. Thaksin's decision to abandon his self-imposed repose was prompted by the nullification of the April 2 elections. In a landmark royal speech on April 25, the king referred to the political turmoil as a “mess” and implied that the elections had been undemocratic. He called on the country's judiciary to sort things out.

On May 8, the Constitution Court nullified the April 2 elections, and shortly thereafter, the Criminal Court launched an investigation into alleged inappropriate behavior (read: pro-Thaksin favoritism) by members of the Election Commission, resulting in the unprecedented incarceration of three election commissioners.

Over the summer Mr. Thaksin came under attack from all sides, especially from an increasingly empowered judiciary, as the charismatic politician faced a barrage of legal cases against either him or his party. Some of these—such as a criminal case for perjury brought on by a former business associate—had been on the horizon for a while. Others emerged more recently, such as the Constitution Court's case concerning the possible dissolution of TRT for election improprieties (other parties are facing similar probes), as well as the Auditor-General's investigation into alleged tax evasion by members of Mr. Thaksin's family. An investigation by the Ministry of Commerce into the controversial deal whereby the Thaksin family-owned telecommunications provider, Shin Corp., was

sold in a \$1.9 billion, tax-free deal to Singapore's Temasek Holdings—could re-ignite the current political meltdown.

Mr. Thaksin's speech on June 29, in which he accused a "charismatic, extra-constitutional figure" of interfering with the country's democratic process, has only made matters worse. Later, when pressed by reporters, Mr. Thaksin refused to elaborate on his provocative remarks. Most analysts agree that he was referring to the president of the Privy Council, General Prem Tinsulanonda, himself a former prime minister and former commander-in-chief of the Royal Thai Army. Gen. Prem is also the king's right-hand man. Whether Mr. Thaksin's comments were therefore meant to be an indirect slight to the king, as some have surmised, remains the subject of debate. If that proves to be the case, then Mr. Thaksin's challenging posture marks a significant departure in Thai politics as no prime minister has ever shown such audacity toward the palace.

Gen. Prem weighed in soon afterwards, firing his own salvo while dressed in full military uniform. In an address to the graduating cadets of the Chulachomklao Royal Military Academy, he reminded the young soldiers that they served the king and not the prime minister. "In horse racing, horse owners hire jockeys to ride the horses. The jockeys do not own the horses," the Bangkok Post reported him as saying. Gen. Prem continued: "A government is like a jockey. It supervises soldiers, but the real owners are the country and the king." Subsequently, as reported by the Bangkok Post, the general told a gathering of naval officers that: "Individuals who have no ethics and morals are bad people who are full of greed. They may want to live comfortably with a lot of money. But if they have acquired wealth through illegal or unethical means, they no longer deserve to be in this country." Again, while no names were mentioned, there was little

doubt among commentators that the general was referring to Mr. Thaksin.

If Gen. Prem's words didn't send a strong enough message to Mr. Thaksin, army commander-in-chief General Sonthi Boonyaratkalin's actions should have. In mid-July, Gen. Sonthi re-deployed a large contingent of pro-Thaksin officers out of key positions in Bangkok and into the hinterland provinces. Many of these transferees were part of the famous Class 10 group, former classmates of Mr. Thaksin from his days in the armed forces and known, vocal supporters of the prime minister. Their removal strips yet another potential weapon from Mr. Thaksin's arsenal.

Which Way Out?

THE KING HAS long been revered in Thailand as an almost godlike figure. His subjects must prostrate before him, as seen in the photograph at TRT headquarters. Should they need to address his majesty directly, they do so using flowery, archaic language. This is one of the last countries in the world where a politician—indeed anyone—would want to challenge the king, directly or indirectly. When the palace speaks, everyone listens.

Some royal interventions are very public in nature. In a 1992 televised meeting, for instance, the king famously called for a peaceful resolution to a standoff between General Suchinda Kraprayoon and Major General Chamlong Srimuang. But these cases are rare. Even though he is entitled by the Constitution to intervene under limited circumstances, the king has only seldom done so. Other interventions have been more subtle, with the king exerting his influence through proxies such as Gen. Prem.

Yet Mr. Thaksin seems undaunted. The caretaker prime minister is determined to fight on, perhaps because he is genuinely convinced he has a true mandate from the

Less sanguine analysts fear a bloody confrontation on the streets of Bangkok.

people. It would be his duty, therefore, to stand by his supporters and continue fostering economic opportunities for the rural poor. There is no denying that he has been democratically elected, not just once but on several occasions. (Three, if the April elections are counted.) It is as if Mr. Thaksin is asking: Why should I be forced to step down?

Equally, it could be that Mr. Thaksin has too much to lose. If he steps down, he could be put on trial, have his assets frozen, maybe even imprisoned. Mr. Thaksin and TRT would be destroyed. Many believe that, at this stage, Mr. Thaksin either stays in office or is sent into exile—or worse. There are few alternatives, they say, since Mr. Thaksin has made too many enemies—hence his desperate clinging to power.

Or is it that Mr. Thaksin is looking at a longer time horizon? At 57, he is still very young and could quite feasibly lead Thailand for several decades to come. The same cannot be said for the 78-year-old king—the world's longest serving monarch—who underwent life-threatening spinal surgery in July. Perhaps Mr. Thaksin believes that, if he manages to survive the challenges to his leadership, he might live to see the day when Thailand—under a new king (or queen)—might be a different place where the influence of the monarch is not as pervasive.

For Mr. Thaksin, the main questions are whether he will continue to run for election and, more importantly, whether he will stay on as prime minister if he wins. Most analysts expect Mr. Thaksin to run as planned, if only to ensure that TRT can get as many votes as possible. Many also believe that the TRT will win—assuming the party has not been dissolved by the courts in the interim. Mr. Thaksin could

then decide to step aside for a period. But this sounds all too similar to the plan hatched in the immediate aftermath of the April elections, and is unlikely to satisfy the anti-Thaksin forces led by the PAD, who say they will not stop short of getting Mr. Thaksin out of Thai politics for good.

A more prudent approach would be for Mr. Thaksin, if re-elected, to make greater concessions that go beyond simply stepping aside. These could include undertaking to genuinely embrace reform—constitutional reform, reform of his personal style of politics and an overhaul of his party. If such concessions were sufficiently broad, and the intent behind them pure, then Mr. Thaksin could bide his time until he stages a comeback in a fresh set of elections. Unfortunately, Mr. Thaksin's track record to date shows a clear reluctance to make concessions and an even greater aversion to changing his personal style.

What are the next steps for the palace? No doubt it realizes that it must tread carefully in the coming months. Any overt intervention would entail its own set of risks. In 1992, the king moved to prevent an unelected figure from inflicting his will on the majority. This time, the leader, while hugely unpopular in certain quarters, nonetheless enjoys an overall majority support from the people. The fact that the king signed the electoral decree, paving the way for the October elections, is seen by many as a signal that he still believes the impasse can be overcome without his direct intervention.

There is still the chance Mr. Thaksin will get tripped up by one of the many legal cases he faces. For the king, this would conveniently make the problem Mr. Thaksin represents quietly disappear. But there is no guarantee of this happening, and Mr.

Thaksin could still nimbly maneuver his way through the legal minefield and emerge unscathed.

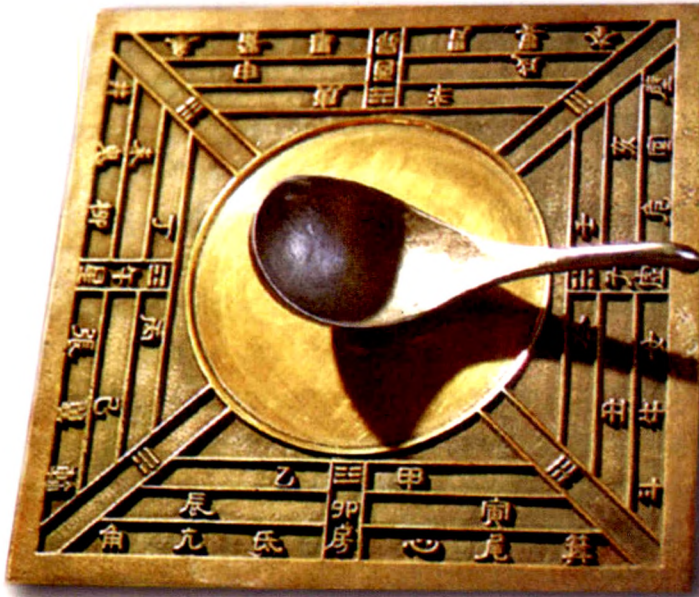
To be sure, a military intervention to oust Mr. Thaksin is always a possibility, although some—but not all—analysts agree that this seems unlikely at this point. Those with less sanguine views predict that there will be no compromise between the two, and say that this game will produce only one winner and one loser. If this turns out to be the case, then the next weeks and months could see bloody confrontation on the streets of Bangkok and throughout the kingdom.

Clearly a more positive conclusion would see the king and Mr. Thaksin decide that they have to learn to coexist. It would be a painful scenario for both sides to endure, but in some ways the two do need each other. Mr. Thaksin needs the tacit approval of the king if his period in office is not to become stymied by ongoing calls for

his resignation from the PAD and its supporters. The palace would benefit from a period of stability in which to plan for succession and the next era of the monarchy in Thailand.

As such, the current impasse represents an opportunity to usher in a period of more transparent democracy, while providing a timely chance for a review of the relationship between democratic institutions and the palace. But to take full advantage of this opportunity, all sides must be genuinely willing to learn from this experience and embrace meaningful change. Any “Thai style” solution that allows for face-saving opportunities for the prime minister or the palace would only postpone the inevitable changes that are needed. The result would be an unsatisfactory resolution to the crisis that simply removes the symptom of the problem—Mr. Thaksin—without addressing the underlying challenges facing Thailand. ■

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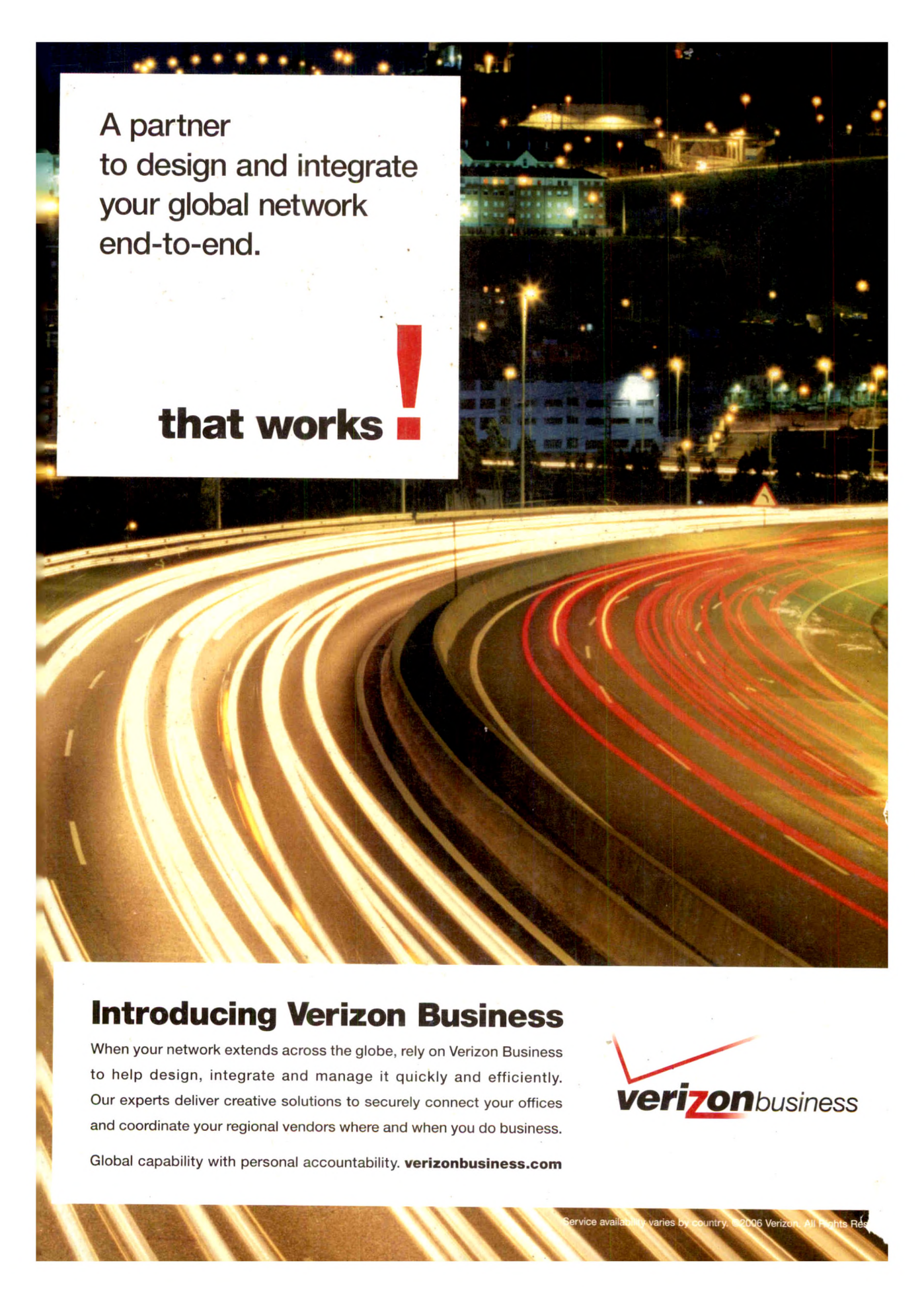
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A nighttime photograph of a city street with long-exposure light trails from cars, creating curved streaks of white and red light. In the background, city buildings and streetlights are visible.

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The World Bank's China Delusions

by Weijian Shan

A STORY HAS BEEN going around that Chinese firms, state-owned or otherwise, are highly profitable and retain too much of their earnings. It is these profits, rather than bank loans—the story goes—that have financed China's surging capacity and rapid economic growth. Most recently, the World Bank sought to lend credence to this tale by running it in its China Economic Quarterly.

The Bank believes that return on equity capital by China's state-owned firms increased from 2% in 1998 to 12.7% in 2005, and from 7.4% to 16% by nonstate-owned firms. These translate into an average return on equity investment of more than 15% for all industrial firms—respectable by almost any standard. Of course, these are the numbers that the National Bureau of Statistics (NBS) has been reporting all along.

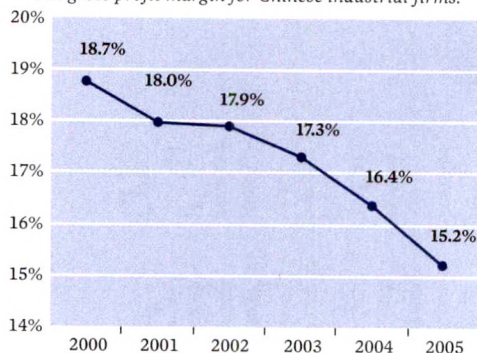
Based on these numbers, the Bank concludes that China's rapid growth in capacity-expansion and fixed-asset investment poses no particular danger to the country's banking system. That's because, it says, the majority of China's investment is

not financed by bank loans, but rather, by retained earnings.

Neither do World Bank economists foresee a danger of overheating or overcapacity in China. Mainland companies have earned so much that their retained earnings now represent 20% of GDP. Indeed, if investments generate more than 15% return, on average, what better use is there for their money than to continue making investments? Why should China slow down at all? Accordingly, China's investment rate is not too high, but arguably too low, as some leading Chinese economists have recently suggested.

This finding is quite astonishing, as it contradicts some well-known truths about the Chinese economy. The fact is that bad loan problems have plagued Chinese banks for years, which is why the Chinese leadership has recently made a vigorous effort to reform the system. How can there be a significant nonperforming loan problem if banks finance only a small portion of growth behind so much equity? Indeed, if

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MARGIN SQUEEZED*The gross profit margin for Chinese industrial firms.*

SOURCE: NATIONAL BUREAU OF STATISTICS

investments in general are generating as much as double-digit returns, why should banks worry about getting paid even if all the investments are financed by bank loans? If firms are so profitable, where do the hundreds of billions of dollars of China's reported bad loans come from?

Of course, the reality is quite different from the World Bank story. In recent years, Chinese manufacturers have been caught in "biflation"—soaring raw materials costs coupled with either flat or declining prices for finished products. Data show the prices of raw materials are up on average by about 37% since 2002. China's consumer-price index crept up only 6.2% during the same period, while prices of Chinese exports to the U.S. have actually fallen by 5.2%. With a deterioration of the terms of trade, profit margins must be severely eroded. So how can Chinese firms appear to be so profitable?

To get to the root of this question, I went back to the same data source that the World Bank used to derive its results. What I was able to find tells quite a different story.

The NBS database tracks industrial firms with annual revenues of 5 million yuan (\$627,000) or more. The number of such firms rose from 155,000 in 2000 to more than 250,000 in 2005. For these firms, data are available, in aggregate, for such financial items as total assets, liabili-

ties, sales revenue, costs of goods sold, major expenses and of course profits.

But, notably, NBS officials confirm that the reported "profits" are not net of income taxes. The return on equity investment number reported by the World Bank is thus inflated by as much as one-third—China's standard corporate tax rate.

Income taxes are not the only missing data. Instead of taking the reported profits number at its face value, one can derive profits by deducting, line by line, major expense items from sales revenue. Such an exercise would produce, in the case of Chinese firms, a before-tax profit number smaller than the one reported on the "profits" line in the database. Officials of NBS tell me that this is because "profits" also include "investment income" and "income from subsidies," which are not reported separately in the published data. There is no telling the size of the government subsidies included in the final profit number, but they obviously should not be counted as part of a firm's true profit.

It is "investment income" that further exaggerates the profit number. One notable change within Chinese firms over the past decade has been the increasing diversification of their ownership or shareholding structures. There are very few firms of "significant scale" still 100% owned by the government or by private individuals. Corporate restructuring and formation of new firms have created, typically, multiple corporate or individual shareholders. When firms pay a dividend to their corporate shareholders, it creates an investment income. This means that the same profits are reported as profit once, and then maybe more times as investment income, as the same money is paid out in dividends to corporate investors or shareholders. To figure out the true profitability of an industrial firm, such income should be taken out to avoid double accounting.

Double accounting of investment in-

Beyond any doubt, Chinese firms continue to be net borrowers, not net savers or creditors.

come ordinarily does not change the calculation of return on equity. The same profit may be counted multiple times, but the amount of equity will also be counted just as many times, resulting in an unchanged ratio. Problems arise because losses are only counted once but not multiple times because no dividend or investment income is distributed. It is therefore the double or multiple accounting of profits, but only single counting of losses, that inflates profitability number. If government subsidies and investment income are excluded from reported profit figures, another couple of percentage points need to be shaved off the reported return on equity number.

Therefore, depending on the effective income tax rates, and how much subsidies and double accounting of investment income are included in the calculation, the true profitability number for Chinese industrial firms could be as much as 6 to 7 percentage points less than the 15.3% number from the World Bank results. The average profitability of Chinese industrial firms after such adjustments comes down to no more than 8% to 9%, a mere 3 to 4 percentage-point premium over China's average best lending rate of 5.7% in 2005, and far below the 6% to 9% premium for Hong Kong and U.S. listed firms in the same year.

The performance of Chinese companies listed simultaneously on Shanghai and overseas stock exchanges also confirms that return on capital in China is generally lower than on overseas markets. On average, the stock price differentials of the same companies traded on domestic and overseas exchanges can be as much as 30%, indicating that return on capital within China is about 30% lower than without.

But that's still not the end of the story. Chinese industrial firms are indeed suffering from falling profit margins caused by biflation. As seen in the accompanying graph, gross profit margin has been declining steadily between 2000 and 2005. The margins for Chinese industrial firms have been squeezed because relentless capacity expansion has created, on the one hand, high demand for raw materials and increased prices in the global market and, on the other, overcapacity that has depressed prices of finished products.

As a result, many Chinese firms are struggling. Of the industrial firms captured in NBS's database, 23% incurred losses in 2005, while more than one-third of state-owned firms continued to lose money. The fact that China is a net importer of raw materials means its firms will continue to pay an increasingly high price, in terms of reduced profits, to commodity-producing countries.

It should be noted that our true profitability numbers still do not account for potential write-offs in accounts receivables. Almost all firms write off a portion of aged receivables once deemed uncollectible. Since reported profits are not retroactively adjusted, the true net profit should be even smaller, unless the potential write-offs are previously and sufficiently provided for.

In China, a clear sign of overheating is the increase in receivables. It was the mounting "triangular debts," or receivables, which led to a severe "austerity program" in 1994-95. More recently, the State Asset Supervision and Administration Commission has reported that in the first half of this year, receivables for 166 "centrally controlled" (read: largest) SOEs have increased 14% from a year ago, representing 16.2% of sales. Moreover, for 36.1% of

LOAN TAKERS

Chinese corporations' deposits and loans with domestic banks, in billions of yuan.

	Total Deposits	Deposits by enterprises	% of Total	Total Loans
2001	14,362	5,155	35.9%	11,231
2002	17,092	6,003	35.1%	13,129
2003	20,806	7,249	34.8%	15,900
2004	24,053	8,467	35.2%	17,736
2005	28,717	9,614	33.5%	19,469

SOURCE: PBOC

them, receivables account for more than 30% of total sales. These are clear signs of overheating, and they create particular risks for banks as receivables are likely to be financed by bank loans.

Data do show that Chinese firms had improved their profitability between the late 1990s and 2004, after which global commodity prices began to take off. It seems that at least part of this early improvement can be attributed to an increase in productivity. NBS reports that the cumulative annualized growth rate of China's labor productivity is 19.6%, in nominal terms, in the past seven years. However, the wage rate has also been rising, at about 14.1% per year during that same period of time. Net productivity gain is roughly 5.5% per year. Between 1998 and 2002, the productivity gain outpaced the rise in China's purchasers price index, which only crawled up about 1.1% per year on average. But between 2003 and 2005, PPI rose by about 8% per year, far exceeding any real productivity gain.

Any suggestion that Chinese firms are super savers ignores the facts. Large as corporate deposits may be in terms of China's GDP, they only represent one third of total deposits in China's banking system, and have been declining in the past five years (as shown in the table nearby).

Chinese firms of course borrow much more than they deposit. Much of their deposits, in fact, are not for the purpose of

saving, but rather to secure bank credit. For safety, Chinese banks require that corporations seeking a loan or guarantee put down a deposit of as much as 40% to 50% of the borrowed amount. It is beyond any doubt that Chinese firms are net debtors, not net savers or creditors.

The profitability of Chinese industrial firms, or their retained earnings, cannot be the main drivers of China's capacity-expansion and fixed-asset investment. There is no question that China's growth continues to be financed by banks. In fact, total investment by industrial firms likely accounts for no more than 20% of the country's annual fixed-asset investment. Bank loans, on the other hand, are greater than China's GDP. Furthermore, off-balance-sheet credit can be as much as 80% of loans. Combined, bank's total credit likely equals two times GDP. The financial means of industrial firms, whose total net asset value is no more than 50% of GDP, or approximately one year's worth of China's investments, pale in comparison.

Chinese firms will continue to suffer from low profitability and low return on investment until China transitions away from this growth model of capacity expansion before domestic demand. This creates an increasing need to borrow as cash flows cannot meet the requirement for capacity expansion, increasing the risk for Chinese banks. The Chinese leadership clearly knows this. It has taken measures to cool down the economy and scale back investments.

Ultimately, to sustain growth, China needs to gradually transition itself from a growth model led by ever greater investments to one led by private consumption and productivity gains. It seems that China is already in the process of such a shift, whose success will no doubt improve the efficiency of its economy and free it from self-inflicted biflationary shocks. ■



Japan Turns Its Back on Reform

by Jesper Koll

ON SEPT. 20, Japan will lose a major impetus for reform when Junichiro Koizumi steps down as the country's prime minister and leader of the ruling Liberal Democratic Party. The departure of Mr. Koizumi will probably signal the end of Japan's short-lived golden age of pro-market reform, and the beginning of a return to old ways of stifling regulation, frequent government intervention and preservation of the status quo.

Shinzo Abe is expected to be the man to take the helm in post-Koizumi Japan. Mr. Abe, who will turn 52 just one day after the LDP leadership is decided, will struggle to live up to Mr. Koizumi's legacy. He faces a very different Japan from the one Mr. Koizumi had to deal with when he first rose to power. Furthermore, Mr. Abe's personal style and political beliefs are unlike his predecessor's.

When Mr. Koizumi seized power in April 2001, Japan was in a desperate state. The economy was at the brink of a deflationary spiral—the banks were bankrupt, unemployment was surging and Japan Inc.

was losing global competitiveness fast. The popularity of the then LDP president and prime minister, Yoshiro Mori, had fallen to below 10%, well under the 30% that LDP leaders traditionally considered to be the minimum tolerable support level.

But the maverick Mr. Koizumi successfully stopped the rot and offered hope for renewed prosperity. Importantly, his policy team was handpicked from outsiders rather than the usual crew of jaded insiders. Mr. Koizumi surrounded himself with independent thinkers from academia, business and the arts who shared his conviction for pro-market, antitechnocrat philosophies. Traditional party factional balances meant nothing to him. He selected his cabinet on the basis of merit, not seniority or favoritism, something revolutionary if not heretic in Japan.

More importantly, Mr. Koizumi actively promoted an agenda very different to the traditional Japanese model of economic and policy management. At the core of Mr. Koizumi's plan stood the privatization of

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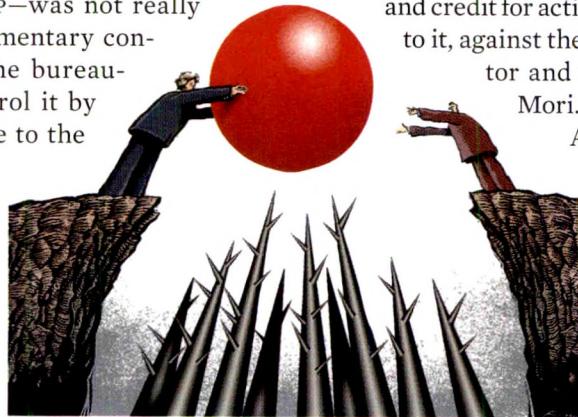
Japan's postal-savings system. Mr. Koizumi had been pushing for this actively since the early 1990s. As much as one-third of the savings-into-investment allocation in Japan used to go through the postal-savings and postal-insurance system. This unique form of financial socialism formed the capital base of Japan's bureaucratic power. Funded by postal deposits and insurance premiums, Japan's second budget—the Fiscal Investment and Loan Program, or FILP—was not really subject to parliamentary control. Basically the bureaucrats could control it by giving preference to the various vested interests that then used it to exercise power over individual politicians and, ultimately, the LDP. On top of funding “bridges

to nowhere” and other public works, the postal-savings system funded below market rate loans to “zombie” companies, or companies that were deemed to be politically too sensitive to be allowed to go bankrupt. Make no mistake: By focusing on privatizing the postal-savings system, Mr. Koizumi has laid the groundwork for what could potentially be a fundamental change in Japan's economy. Now private savings must find their own way into investments rather than rely on the guiding hand of financial socialism.

Thanks to Mr. Koizumi, Japan's economy is experiencing a sustained economic recovery. The banks are well capitalized and eager to lend, employment is growing and corporations enjoy record profitability. When Mr. Koizumi came to power, the national mood was that of crisis. Today, self-satisfaction and complacency are making a comeback.

The first priority of Koizumi's successor will be to secure continued LDP majority rule. This may turn out to be a very difficult task and the downfall could come as early as next year's Upper House election in July 2007. If the LDP loses 13 seats, it will lose control of the 242-seat Upper House. In the last Upper House election it lost 19 seats despite Mr. Koizumi's record popularity. So the challenge for the new LDP leader at the polls is serious. Mr. Abe deserves respect and credit for actively wanting to rise to it, against the advice of his mentor and faction leader Mr. Mori.

A tough election ahead raises the probability of a renewed focus on populist policies. In order to appeal to voters, all of those vying for Mr. Koizumi's job are em-



HADI FARAHANI

phasizing their “socially aware” policies in the quest for easy sympathy votes. The gist of their message is the need to redistribute rather than create income and wealth. Moreover, foreign- and security-policy concerns are increasingly being played up as though they were more important than the need for added domestic economic reforms. However, it remains to be seen how long a more constructive China policy, for example, can distract voters' attention from inaction on pension and healthcare policy.

Just as Mr. Koizumi set a high benchmark for his successor with his electoral success, his economic policy also puts the next leader in a difficult spot. Apart from postal privatization, Mr. Koizumi's basic economic policy was dominated by two central themes on the fiscal front: no new taxes, and expenditure cutbacks.

The details of the actual budget allocation demonstrate that Mr. Koizumi's drive

Mr. Abe pays lip service to economic reform. Yet he has no deep-rooted philosophy on economic policy.

for “small government” was primarily focused on cutting public works. He sliced that budget from about 2.5% of GDP to 1.4%. However, spending on social security and local allocation tax grants—redistributions from the central government to regional ones—continued to rise relatively unchecked. Also, national debt service costs increased relentlessly. This sets the stage for Mr. Koizumi’s successor, who will have to deal with difficult fiscal consolidation issues and with the reform of the country’s social-security system.

Mr. Koizumi’s focus on cutting back public works was an attack on only one specific interest group: the general construction contractors. By painting them as villains who waste taxpayer funds, he gained popular support. His successor faces complacency at best, and at worst a backlash from rural voters who want a quick fix to lingering regional economic problems and demand more public spending. Faced with the double challenge of a tough election and potentially unpopular budget and fiscal options, most likely the new prime minister will do whatever it takes to avoid making real decisions on social security, local transfer grants or taxes for as long as possible.

In addition to delay on the real tough decisions, divergence and distraction will be popular tactics to keep the Japanese electorate occupied. One clear way to do this is to stir up nationalism. Mr. Abe’s Japan is, in the words of Tokyo’s governor, Shintaro Ishihara, a “Japan that can say no”; a Japan that insists on a playing a strong leadership role in Asia and the world. The focus is the Japan-Asia relationship and, more specifically, the country’s thorny relationship with China. While Mr. Koizumi also appealed to na-

tionalist sentiments, he insisted that Japan’s economy could be reformed and return to its status as one of the world’s leading competitive powerhouses. Now that Japan’s economy is back, Mr. Abe can take it to the next step and try to translate economic power into real political and diplomatic power. If he plays his cards right, a Japan-China summit meeting should be possible under his leadership. But that’s foreign-policy reform, not domestic economic reform.

Of course, Mr. Abe pays lip service to economic reform. Yet he has no deep-rooted philosophy on economic policy. He has been seen as a very savvy power broker who may perceive that there are no real economic issues that can be easily exploited for political gain. For example, Mr. Abe has rarely sought out leaders from the business, financial or academic community for policy advice. Instead, his inner circle consists of fellow politicians or bureaucrats. Tellingly, Japan’s powerful top business lobby, Keidanren, was very open in its support for another LDP leadership candidate, Yasuo Fukuda. The main reason here is Mr. Fukuda’s promise to build more constructive Japan-China and Japan-Asia diplomatic relations, which Japan’s corporate elite very much wants. No doubt Mr. Abe will want to win over more active support from the business community, least of all since Keidanren is starting to raise political contributions again. That alone suggests some incentive for Mr. Koizumi’s successor to be constructive on Japan-China relations. At the same time, whether reforming Japan-China and Japan-Asia diplomacy offers enough long-lasting political capital to remain popular by the next recession remains to be seen.

Mr. Abe does, however, have good pop-

ular support from his focus on sociopolitical issues. Frictions in society have risen because of Mr. Koizumi's radical reforms. Mr. Abe's support group in the LDP is called "Sai Challenge," which can be loosely translated as "give losers a second chance." Here, the contrast between the economic philosophy of Messrs. Koizumi and Abe comes through in its purest form.

Mr. Koizumi and his team were outspoken on the need for Japan to promote "winners." Lifetime employment should be exchanged for pay-for-merit and successful companies be allowed to prosper freely, while bad companies should go out of business and big government be privatized to give winners a chance.

In reality, these tough-sounding slogans were transformed into a Japanese version of Reaganomics. Still, the changes in Japan's society have been enormous and far reaching. The gap between winners and losers has widened on many economic measures. The national debate on the issue is very heated—not surprisingly so, as one of Japan's most important achievements during the past 50 years has been the combination of both high growth and speedy economic development combined with remarkable income and asset equality. Mr. Abe's wish to create a "kinder, gentler Japan" is not only popular, but strikes a deep-rooted nerve in Japan's underlying economic culture.

Taken to its logical conclusion, Mr. Abe's focus on income inequality could result in a rise in the top income-tax rates. At the same time, he should argue against a rise in the consumption tax, as such a tax would be regressive and actually widen the gap between high- and low-income earners even further on an after-tax basis.

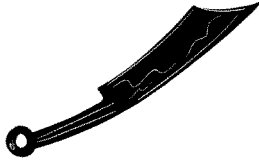
Mr. Abe is focused on many other social issues. For example, Japan has seen a sharp rise in child poverty. Although it seems incredible, 14% of Japanese children live in poverty, which is above the

OECD average of 11%. For a country that also boasts 14% of the world's millionaires, this is a shocking statistic.

Dealing with rising inequality, growing child poverty, declining education standards and other social issues that have arisen in the past decade is tricky. Mr. Abe's wish to give those who lost out in the economic recovery a second chance is bound to boost his popularity. Whether counter-policies will bring "bigger government" or rely on private enterprise solutions remains to be seen. So far, the government's track record is not impressive given, for example, the failure of implementing proper education reform. Grading high school students on their "national pride" and ending middle school sex education—two recently enacted reforms—are hardly progressive. Of course, the blame for this should go to Mr. Koizumi, but at the same time, Mr. Abe has been an integral part of his administration's social policy-making process.

The common thread of post-Koizumi policy priorities is poised to be more state intervention—bigger, not smaller government and stricter rules and regulations. Unlike Mr. Koizumi, Mr. Abe has never surrounded himself by outsiders for advice. His policy advisers are predominantly insiders—bureaucrats and fellow LDP politicians. Chances are that the post-Koizumi focus will be on the protection of vested interests, more so than the promotion of new, forward-looking reforms.

The good news is that drastic policy mistakes are unlikely, due to the election cycle and the large fiscal deficit. The former makes sharp tax hikes improbable and the latter should guarantee against a re-emergence of pork-barrel politics. Post-Koizumi Japan may well be a return to the "normal" Japan where insiders rule and dictate the consensus. The golden age of pro-market reform is over. Outsiders and reformers may have to wait for the next crisis. ■



Facing the China Corruption Challenge

by Kenneth J. DeWoskin and Ian J. Stones



CORRUPTION IN CHINA has again risen to the top of many corporate agendas. This is partly in response to the growing size of MNCs in China, the growing importance of their China revenue and the growing intensity of competition for market share. But it is also a response to widespread media reports of significant fines levied by the U.S. for violations of the Foreign Corrupt Practices Act, as well as a recent OECD report expressing discontent over the poor enforcement of its multinational anticorruption covenants. Pre-emptory actions by some large corporations to purge their China organizations following internal investigations have helped move corruption up the corporate agenda. However, it is both interesting and troubling that no consensus has emerged on how to deal with the overlay of informal transactions in China's economic life.

China's central authorities appear to be stepping up their efforts. In February, Wu Guanzheng, secretary of the Party's disciplinary department, announced a campaign to step up investigations into Party

officials' behavior as well as commercial business cases. Ouyang Song, deputy of the organization department within the Communist Party of China (CPC), held a press conference in July, ending an 18-month, three-phase internal education program involving 70 million Party members—the largest such program in CPC history. Even the Party's public statements make clear that this fight is not only about what kind of party they want, but their continued viability and dominance.

China's long hot summer has not been pleasant for many officials. To name just a few celebrity expulsions: On June 9 Beijing Vice Governor Liu Zhihua, in charge of lucrative Olympic construction, was removed; last month, Wang Shouye, former deputy commander of naval forces in the Chinese People's Liberation Army (PLA), was expelled from the national legislature for economic crimes; and Liu Zhixiang,

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Family members react to the guilty verdict for reporter Yang Xiaoqing, convicted in June this year for exposing official corruption.

former deputy director of the Wuhan Railway Bureau and brother of the current Minister of Railways, Liu Zhijun, was given a suspended death sentence for corruption-related crimes. Another vice mayor, and the executive vice president of the Beijing Organizing Committee for the Olympic Games (BOCOG), Liu Jingming, along with the heads of 23 BOCOG departments, signed a pledge to combat corruption within days of the sacking.

Commercial crime is being addressed with increased urgency. In June of this year, an audit of the Agricultural Bank uncovered \$6.45 billion in irregularities, leading to the firing of 64 employees and disciplinary action against 1,300 more. More than \$1 billion was involved in serious criminal cases and \$3.5 billion in irregular loans. The banking sector is the epicenter of large scale commercial corruption. As a result of the disclosures at the Agricultural Bank, the Chinese Banking Regulatory Commission announced measures to fight corruption and fraud in banks, co-operative credit units, trust firms and asset management companies.

In May, the Central Commission for Discipline Inspection for the first time released figures on its work since it launched an interdepartmental team to tackle bribery in February. It reported receiving leads in more than 9,000 cases of commercial bribery, opened probes into 4,367 of them,

is preparing indictments on 1,195 cases and has passed more than 674 cases to the courts. The PLA has been very public this year as well about newly invigorated investigations into procurement and business corruption within its ranks.

Measures to protect minority shareholders' interests are being introduced by China's stock exchanges. In an unprecedented move, the Shanghai and Shenzhen exchanges in June published a list of 189 publicly traded companies with a total of \$4.2 billion misappropriated by big shareholders and affiliates. The list came two days after the China Securities Regulatory Commission issued a notice ordering misappropriated money at publicly traded firms be repaid at a faster pace. Companies are put under market pressure and finding their credit reduced, while judicial measures are being considered by the Supreme People's Court to bring criminal charges against embezzlers of funds from publicly traded firms.

Judicial reform has been taking place alongside anticorruption drives. A basic flaw is that top court officials in every jurisdiction are mainly appointed by, and are responsible to, the local party and government. Because local economic interests are often at stake, serious interference by local officials in judicial proceedings has led to the appointment of Supreme Court judges to lower courts.

Corruption and the fight against it always engender political tensions between the central government and the provinces, as well as between the provinces and the locales. In China there is an historic sense of entitlement that goes with high office, and in this gray area the issue was primarily about proportion. Customs officials attracted punishment only when their expropriations became disproportionate to what they produced for the higher levels. The extent to which individual judgment determines every step of indictment, inves-

Foreign businesses operating in China are caught in a paradox, pitting ethics against potential growth.

tigation and adjudication makes each of those steps very political.

Whether there is a genuine escalation of anticorruption activities by the Party or primarily an energetic campaign to publicize them is difficult to determine. And whether the campaign, if more significantly energized than previous campaigns, is really achieving its goals, is likewise hard to gauge. The CPC expelled 44,738 members in 2005 who “failed to meet Party requirements,” slightly down from the 49,000 expelled in 2004. But an overarching theme is that stronger and more objective legal processes are now being installed. This indeed would be welcomed by domestic and foreign interests alike.

Viewed from the ground, one often finds sympathy for the cause of reducing corruption, but pessimism about the prospects. Some officials in private simply say that corruption is so deeply rooted in the fast-growing economy, and its fabric so tightly interwoven, that it is difficult to discern whether things are improving or degrading. Most agree that this is not a battle to be won in some definable time frame; rather, it is a very long march. It is clear in China that corruption is part of the marketization process, and some economists argue it is an important precursor to a more open marketplace. We understand that the growth of corruption and the fight against it are both entangled in the details of economic reform policy and practice.

At the top, the Party’s efforts to curb corruption focus on the CPC’s immediate interests, and these are, at the core, different from those of foreign investors. An important point, not to be lost, is this: Since reforms began, the biggest victims of corruption in China, after the people themselves, are the Party and the state, by

almost any measure.

From the establishment of the Contract Responsibility System in the early 1980s to the recent surge in domestic mergers and acquisitions, no amount of ingenuity has been spared in devising ways to convert rural land and developed property, and divert industrial assets and their earnings, away from public ownership and into the hands of politically connected private parties.

The majority of the CPC disciplinary cases of the last several years focus on economic crimes related to asset conversion, especially property and land sales, involving collusion among local party officials, local developers, and local banking authorities. Although China’s top auditor, Li Jinhua, has described these schemes, no one has put a number to these losses.

In fact, these ubiquitous practices contribute significantly to the twin crises of bad lending and overheated property investment, both driven by the promise of illicit private gain as well as real commercial potential. So their damage to the overall dynamics of quality growth in China is highly geared. The real cost of corrupt conversion in China is likely to be in the same ballpark as the aggregate cost of poor quality bank lending and NPL generation and overheated property development.

But irregular asset conversion is not the corruption plague that increasingly worries foreign investors. Their troubling issues focus on the domestic trading systems, not the conversion of capital assets. With the final phase-in of China’s WTO commitments, foreign investors are taking advantage of new regulatory space to build capacity in sourcing, distribution, and sales. Deepening involvements in trade channels bring them face to face with pervasive corrupt trade practices.

In many cases, MNC brand owners operating in China feel the grip of a paradox, pitting necessary global business practices and ethics—not to mention legal obligations—against bountiful potential business growth in many of China's most enticing domestic markets. As foreign-invested business interests go downstream, this paradox will become increasingly intense.

For foreign investors, one thing that bears careful observation is the direction that impending remedies created by the CPC and the state might take. They have the potential to bring relief, but anticorruption reforms also have the potential to create new risks and market challenges. Nothing illustrates this better than the campaigns launched in early spring to rectify markets for medical equipment, supplies and pharmaceuticals.

Kickbacks for buying agents, mandated consultants, sales agents and distributors, as well as other forms of corruption have distorted China's healthcare markets for at least a decade. As a third-party payer, the state is also a victim here, but a genuine concern about the affordability of health care for private as well as publicly funded channels demands action. One media report estimate suggested that as much as 20% of capital equipment costs to hospitals represented kickbacks to procuring agents and hospital directors. That would be an overcharge of nearly \$350 million on this year's projected equipment spending of \$1.7 billion. The situation is even worse in the much larger pharmaceutical markets.

As part of the price regulation discussion, regulators are showing interest in the underlying cost of manufacturing and have views on what they consider acceptable margins. The problems for MNCs are obvious, not the least of which is a potentially intrusive examination of exclusive processes, exposing intellectual property, or accounting for the \$1 billion-plus tab to

bring a new drug to market in a deemed "manufacturing cost." In the medium and long term, these policies could turn major pharmaceutical companies away from China or have a potent simulative effect on the growth of legal and illegal generics.

While the details of the rectification campaign are being worked out, equipment manufacturers already report a sharp downturn in the market. New processes stall deals, and political risk for officials has now become a factor in approving purchases. The longer term impact could be positive or negative, depending now on the quality and integrity of individual provincial authorities, who could become unchecked players in equipment sales.

The real answer lies, at the moment, in an ideal not yet fully achieved in China but arguably within reach. That is a market dynamic in which quality, reliability, transparency, and fair pricing are decisive in winning business, and both the buyer and seller live by that dynamic.

From the standpoint of MNC brand owners, short-term underperformance can be offset with medium- and long-term benefits from effective development of high performance organizations with strong controls and clear value proposition to the market. A clean channel should also become a powerful factor. It is not premature to begin building that capability and reputation.

From the standpoint of the government, reform will have to progress at an accelerated pace. A larger measure of trust will have to be invested in market mechanisms, and more and more of the state's direct administrative controls over large enterprises will need to be relaxed. The separation of regulator and operator will need to advance and regulators will have to become more effectively shielded from an array of other pressure, economic and political. These are the critical reform issues where the interests of China's governing Party and foreign investors converge again. ■



Japan's New Deal for Asia

by Toshiaki Kitamura



IN THE COURSE of the last five years, there has been much discussion about how Asia should integrate—from the East Asia Vision Group's 2001 report, to the findings of the East Asia Study Group released in 2002, to last year's East Asia Summit in Kuala Lumpur. But the time has come to put aside rhetoric and seek out leadership matched with concrete proposals. Japan is willing to do its part in our proposed "new deal" for Asia outlined below.

Japan has been criticized for moving slowly in this regard, but we are just now rebounding from a decade of economic stagnation. Moreover, the structural reforms undertaken by the Koizumi government in various areas, including financial markets, labor markets and corporate governance, are now finally beginning to bear fruit. The Japanese economy accounts for more than half of the GDP in the region and we are keen to see rapid economic development throughout East Asia, as this will support Japan's own continuing economic revival. We have listened to those who criticize us for being slow, and

we now stand ready to go forward to do our part to help shape the shared future of East Asia. We firmly believe our initiatives will contribute to the prosperity and development of the region.

Since the late 1980s, East Asia has experienced breathtaking economic development. Trade, capital flows and development assistance stimulated growth and development so significantly that the region's economies were robust enough to ride out the occasional stumbling blocks and even slumps that arose from time to time. Over three decades, as the world economy grew by 2.6% annually, East Asia achieved an average yearly growth rate of 6.4%. From 1980 to 2003, GDP in the region more than quadrupled, while exports and foreign direct investment multiplied by factors of 6.9 and 16.3 respectively.

In the process, East Asian intraregional trade expanded from 33% of total trade in 1980 to a state where more than half of East Asia's trade is now intraregional, a propor-

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tion higher than that of the North American Free Trade Agreement, almost on par with the European Union. As a result of this development, unique regional production networks have evolved, mainly in the automobile and electronics sectors.

These remarkable results are due, in part, to the expansion of Japan's foreign direct investment and trade in the region. In Southeast Asia in particular, Japan has not restricted its role to purely financial and trade-related activities: The transfer of industrial technologies to the Association of Southeast Asian Nations, or Asean, member states and assistance in developing skills and forging a modern industrial infrastructure are also key components of Japan's relationship with this part of Asia.

The remarkable economic success that the Asean countries have achieved since the 1980s should not, however, eclipse the fact that the region also experienced unprecedented economic trauma owing to the currency crisis of 1997. Indeed, GDP per capita in Indonesia and the Philippines still remains lower than its pre-1997 level. In the wake of the crisis, Asean recognized the need to strengthen regional integration and accordingly tried to consolidate its member countries' economic linkages, and also to deepen their economic ties with external partners, by creating the Asean Plus Three framework to include China, Japan and Korea.

In 1999, Japan embarked on negotiations for an economic partnership agreement with Singapore, and this resulted in a domino effect of regional arrangements in East Asia. China concluded an agreement focusing on its trade in goods with Asean in 2004. In May 2006, the Republic of Korea followed suit, signing a framework free trade agreement with the regional body. As a result, Asean has become the center of this web of regional networks, playing a pivotal role by promoting

FTAS and EPAS with Japan, China, Korea, India, Australia and New Zealand.

East Asia is now at a point where an overarching strategy for further economic development and integration in the region has to be developed. This strategy needs to address a broad range of issues, including defining the basic principles for further economic integration in the region, the future for EPAS in the region, the specific steps that should be taken, and how Asian countries can strengthen the intellectual foundation for supporting further economic integration.

Against this background, Japan's Minister for Economy, Trade and Industry Toshihiro Nikai put forward a series of specific proposals at the Asean Plus Three Economic Ministers Meeting and at the East Asian Economic Ministers Meeting, which took place in late August in Kuala Lumpur. According to Mr. Nikai, the basic principles for expanding East Asian economic integration are:

- *Establishing a free, fair, rule-based regional market economy.* This entails ensuring the liberalization of not only trade in goods but also of trade in services and of investment, trade facilitation, intellectual property rights and the creation of a dispute settlement mechanism to resolve economic and business disputes in an impartial manner.

- *Promoting a bottom-up approach that embraces the participation of business people.* We do not envisage economic integration directed by a single driver.

- *Pursuing sustainable and balanced development in the whole region.* In the quest for integration, each country or bloc has its own tasks. Asean needs to consolidate its own integration. China has to strengthen its commitment to international rules such as WTO agreements. Japan, too, has to continue its structural reforms. We should address the different needs of countries with varying levels of economic development so

It is critical that our integration be open. Japan is opposed to making a closed circle in the region.

as to promote sustainable and balanced development throughout the region.

● *Putting Asean in the driver's seat.* Asean's economic integration is the cornerstone of wider regional integration and this, in turn, will promote ever-increasing development in the Asean economies. For this reason, Asean should stay in the driver's seat of the process, creating ever-increasing regional integration.

● *Maintaining a dynamic and open relationship with outside partners.* Needless to say, economic development in East Asia has always been both supported and characterized by openness and dynamism, through direct investments and trade with partners from outside the region. In order to maintain such unfettered dynamism, it is critical that our economic integration be open and transparent to our nonregional partners. Japan is opposed to making a closed circle in the region.

ON THE BASIS of these basic principles, Mr. Nikai made two specific proposals, representing the Japanese government's position on enhancing economic integration in the region, namely:

● *Initiating a study on a Comprehensive Economic Partnership in East Asia (CEPEA).* The goal of CEPEA is to further develop regional production networks and contribute to economic integration throughout East Asia. The main sources of the development in the region have been and will continue to be dynamic FDI inflows and technology transfers. What we need in East Asia is to create a truly business-friendly framework where entrepreneurial businesses, including small- and medium-sized enterprises, can make business and investment decisions without un-

due cost and hindrance. Therefore, we envisage, after the relevant bilateral and subregional FTAs and EPAs are concluded, a CEPEA which would have a more comprehensive mandate than standard FTAs, with authority over trade in goods as well as investments, intellectual property, services, common rules of origin and economic cooperation among Asean and its EPA partners, namely, Japan, China, Korea, India, Australia and New Zealand. CEPEA will also serve to overcome a "noodle bowl" of rules and tariffs created by bilateral arrangements already in place.

● *Opening a research institute to provide intellectual inputs to assist economic integration, tentatively named the Economic Research Institute for Asean and East Asia (ERIA).* This institute would carry out research and analyses on both Asean economic integration and wider, panregional economic integration. Asean economic integration is the key to wider regional integration, but intellectual inputs also have a vital role to play in facilitating economic integration beyond trade liberalization. Economic integration beyond Asean Plus Three needs support anchored in intellectual debate and discussion on future cooperation. The planned institute will conduct research, analyses and studies on the impact of economic integration and also examine issues that concern all the member countries, such as energy and the environment. It may also provide policy recommendations for facilitating trade, investment and industrial cooperation. The institute will collaborate closely with Asean countries and the Asean secretariat to determine its research agenda and work plan, as well as cooperating with existing research institutes on joint research or other appropriate projects. The institute, in cooperation with

Asean, will prepare inputs for relevant ministerial meetings and meetings of East Asian leaders, while participants at ministerial meetings will discuss these inputs and try to reach consensus. Thus, over the long term, in cooperation with the Asean, ERIA can evolve into a regional policy forum that will function similarly to the Organization for Economic Cooperation and Development. Mr. Nikai said at the Kuala Lumpur meetings that Japan would be ready to contribute \$85 million toward the fostering of ERIA over a period of 10 years.

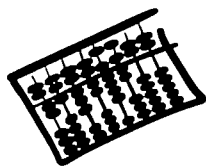
Both of these initiatives were warmly welcomed by Mr. Nikai's counterparts at the Kuala Lumpur meetings. Ministers agreed to establish an expert group to look into the feasibility of CEPEA. At the same time, ministers were briefed on the report by the Asean Plus Three experts on an East Asia FTA (EAFTA) and tasked the senior officials to further study its recommendations. CEPEA is broader than EAFTA in both mandate and membership and will contribute to facilitating discussions by providing a complementary proposal. Ministers also supported the concept of ERIA and welcomed the plan to hold a preparatory meeting this fall among the region's scholars from research institutes.

Some say Japan and China are vying for influence in the region. In fact, the two countries share the responsibility for promoting regional integration. The Energy Conservation and Environment Forum held in Tokyo last May is one example of the joint efforts of China and Japan in tack-

ling common problems facing the region.

Many countries in the region share security arrangements with the U.S., and East Asian economic dynamism has been, and still is, supported by strong ties with countries outside the region. Accordingly, Mr. Nikai's initiatives stress the necessity for economic integration in East Asia to proceed in tandem with strenuous efforts to support and contribute to the international community's interests. Globalization brings many problems for which we must find solutions jointly: energy supplies (energy security), environmental degradation and crushing poverty, to name only three. Japan is willing to contribute to solving and alleviating these difficult issues, and as the only Asian country in the Group of Eight leading nations, Japan is able and ready to play a linchpin role in bridging the two blocs. In this context, the Asia-Pacific Economic Cooperation will play a critical role. Japan is proud of its unwavering commitment to APEC since the latter was founded in 1989. Japan will host the APEC leaders' meeting in 2010, the target year for achieving the Bogor goals of free and open trade and investment in the Asia-Pacific region's developed economies. Together with regional partners, Japan is also keen to "defrost" the suspension of the Doha Development Agenda of the WTO.

Our initiative to deepen economic integration in East Asia will serve as an important building block to bolster free and open economic activities in the Asia-Pacific zone and the world economy as a whole. ■



Macau's Hand Flush With Discord

by Zach Coleman

THE GOOD TIMES are rolling in Macau. The former colony's real GDP this year is predicted to double that of 1999, the last year of Portuguese rule. Unemployment is close to a 10-year low, while the median wage rose 12% last year.

Residents and businesses are enjoying tax cuts thanks to large government surpluses. Local and overseas investors are pouring billions of dollars into construction projects. Meanwhile, new Porsche and BMW showrooms are sprouting up to cater to those reaping fatter paychecks.

Many credit this dramatic turnaround in Macau's fortunes to Chief Executive Edmund Ho. Five years ago, Mr. Ho opened up the city's casino industry to new operators, a move aimed at ending the monopoly of reigning tycoon Stanley Ho (no relation) and prompting the entry of international players.

Similar moves are being made across Asia right now. This past spring, Singapore awarded Las Vegas Sands the right to open the city-state's first casino; bidding for a second resort is currently underway.

Meanwhile, ruling parties in Japan, Thailand and Taiwan are all weighing options for legalizing casino gambling. Even China, which last year rounded up hundreds of thousands of bettors and bookies in a nationwide crackdown, is authorizing new forms of gambling.

And yet, although Macau's gaming liberalization appears to be a smashing success, local residents and businesses are less than impressed.

Elsewhere in the world, the casino industry's impact on local communities is also a controversial topic. But debate generally centers around gambling's vices. The battle lines in Macau, however, are distinctly different. Here, casino gambling has been an economic driver for nearly 160 years—a run that trumps every other gaming center in the world. And unlike Monaco, which bars its citizens from gambling, residents in Macau are free to hit the tables. Yet few do. Instead, most seats these days are filled by mainland visitors. Macau therefore suffers few of the losses; but nei-

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ther do its citizens enjoy many of the gains. And that has residents all in a huff.

Chief Executive Ho's liberalizations have resulted in the entry of five new casino operators: Two are U.S.-based, while a third is from Hong Kong. All three managed to circumvent a 10% minimum local-ownership stipulation by stripping domestic investors of their profit-sharing rights. The remaining two new entrants are 50:50 joint ventures between foreign casino companies, from the U.S. and Australia respectively, and Stanley Ho's offspring.

Though liberalization has not increased local investors' stake in casino operations, the new investments have succeeded in creating thousands of jobs. At the beginning of last year, according to the Macau Statistics and Census Service, there were more workers in wholesale and retail and in manufacturing than in gambling and other recreational services. In the department's latest survey, gambling and recreation emerged as the top employer, with 59% more workers than Macau factories and 31% more than the city's shops. Monthly gambling and recreation wages are nearly triple those of factory workers and 54% above shop wages. According to Deutsche Bank analyst Karen Tang, salaries for experienced casino dealers have risen 64% this year alone.

Middle-aged workers in Macau feel excluded from this jackpot. A large share of hotel and construction jobs is going to workers from the mainland, Hong Kong and the Philippines. The number of legally employed migrant workers doubled over the past four years, to more than 10% the local population. Thousands more work in the city illegally. Inside the casinos, where operators are not allowed to hire migrant workers as dealers—in deference to Beijing's casino ban—middle-aged workers have similarly lost out: Many new hires for dealer positions are younger workers, straight out of high school.

Opinions differ as to why middle-aged workers are passed over. Most arrived in the 1980s as illegal migrants from the mainland, but won residency after the Portuguese administration, in a concession to demonstrators, provided limited amnesty in 1990. Many have worked for years in apparel factories.

Antonio Ng, the most popular candidate in last year's legislative election, says employers prefer outsiders and younger workers because they are easier to exploit. University of Macau economics professor Ricardo Siu, however, believes middle-aged workers generally lack education and skills and would be less productive and harder to train.

Whatever the reason, the fact remains that manufacturing has declined steeply since the early 1990s, when the unemployment rate bottomed out near 2%; it peaked at 6.8% in 2000 and has now come down to 3.8%. Officially 10,000 residents are unemployed, almost three times as many as in 1993. Macau residents fault the government for loosening quotas on import workers too much and for failing to crack down on the employment of illegal workers. Activists are pushing officials to increase employment transparency and force companies to indicate how many outsiders they hire.

Inflation is another key issue, one that affects all residents. After a series of deflationary years sputtered to a close in 2004, the monthly composite consumer-price index has now stayed above 5% for the past year, driven primarily by housing costs. Property prices are up 30% from two years ago as foreign investors spend on expectations of demand from expatriate workers. Ms. Tang of Deutsche Bank expects prices will continue to rise 10% to 15% a year through 2009. The pricing pressure, says Mr. Ng, has compelled the government to resume building public housing for the first time since the Portuguese left.

New investments have created thousands of jobs. But middle-aged workers are feeling left out.

For businesses outside gaming and construction, rising wages and rents are already a problem. Along the busy streets around Leal Senado Square in the downtown center, local shops have been replaced by well-capitalized Hong Kong chains. Macau shoppers are increasingly turning to Zhuhai for their daily needs, putting further pressure on homegrown businesses. Once the giant new casino resorts start opening next year, providing a broad range of shopping, dining, entertainment and other diversions, visitors will have few reasons to spend money elsewhere.

Other side effects of the casino boom also vex residents. Traffic congestion is a major problem, but the government is slow on plans for a mass transit system. Mr. Ng thinks that it is holding back development in case the economy needs a boost later.

This discontent boiled over during a Labor Day demonstration on May 1. Several thousand marchers from independent trade unions repeatedly clashed with police, injuring 25 officers. An earlier wave of protests over foreign labor in 2000 led Chief Executive Ho to initiate retraining programs and new public-works projects. Two years later, the government launched a plan for a crossborder industrial area, in tandem with Zhuhai, that would enlist Macau factory workers in producing goods and services with preferred access to the mainland. Mr. Ho also proposed in his annual policy address last fall to make employers pay a fee for each import worker they hire, but has yet to flesh out that idea. In the wake of the May Day protest, the Labor Affairs Bureau goaded local construction groups into a job-matching fair. Another protest is planned for Oct. 1.

As the first chief executive of the Ma-

cau Special Administrative Region, Mr. Ho has managed to balance competing political demands far more skillfully than his former counterpart in Hong Kong, Tung Chee-hwa. The danger, however, is that as Mr. Ho's final term draws to a close in 2009, jostling among potential successors could interface with rising resentment over the gaming boom's unequal impact.

This could come just as requests for action from casino operators peak. Staffing the new megaresorts will require more than 40,000 additional workers over the next three years, according to Deutsche Bank. In the run-up to the opening of its \$1.2 billion Wynn Macau Casino Hotel this month, U.S.-based Wynn Resorts quietly backed away from demands that the government allow uncollectible gambling debts be deducted from its tax bill—but the company still hopes to get its tax breaks. With competition around the region rising and Singapore charging much lower gambling taxes, operators are keen for the government to reduce its 39% take of receipts.

Mr. Ho remains the arbiter of demands because Macau's half-hearted democratic reforms have left the city without formal political parties and with a legislature half-filled by administration appointees and direct representatives of corporate interests. This likely contributes to the rise of street protests as a means of expressing demands. As University of Macau political scientist Eilo Yu says, the city's elites worry that "Macau seems to be following the path of Hong Kong." Already, "harmonious society" has become as much a buzzword for Mr. Ho as it is for Chinese President Hu Jintao and Hong Kong Chief Executive Donald Tsang.

Mr. Ho will need a new tune to get through the rest of his term. ■



How China Netcom Blew a Windfall

by Cathy Holcombe

THERE ARE TWO ways to read China Netcom Group Corp.'s thwarting of an effective takeover of Hong Kong telecommunications operator PCCW. The first says China Netcom rightly put a double-dealing Richard Li and a band of suspected asset-strippers in their place; the second, that China Netcom blew it.

The answer is behind door number two. China Netcom, the mainland's second largest fixed-line operator, snubbed an excellent windfall gain on an otherwise underperforming investment. Its executives acted in a clumsy and paranoid manner; they reinforced the stereotype that China's state-owned firms invest overseas at Beijing's bidding; and—probably most annoyingly from the Beijing-headquartered company's perspective—made an often press-skewed Mr. Li come out looking like a really cool kebab.

China Netcom already owned some undersea cable networks in Asia Pacific by the time it listed China Netcom Communications Group (Hong Kong) in November 2004, and stated in the prospectus that it

planned to expand its overseas services to win long-distance and value-added customers in China. Thus when the parent company slapped down \$1 billion for a 19.9% stake in PCCW in January 2005, the move fit with its corporate strategy.

What caused gasps was the 25% premium China Netcom was willing to pay for the stake. At the time PCCW was the worst-performing member of the Hang Seng Index for the third year running. The company's core business was beset by competition, and it was still paying off mountains of debt from starry-eyed investments made in the dotcom boom. The majority of analysts covering the company thought it was fairly valued at the HK\$4.75 (\$0.61) range it was trading at the time; China Netcom had stumped up HK\$5.90 per share.

In light of the weighty premium they paid to get in, China Netcom no doubt was miffed when PCCW's chairman started growing conspicuously restless. Mr. Li appeared to welcome an offer by U.S.-controlled equity buyout firm TPG Newbridge

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to buy out minority shareholders of his Singapore-listed Pacific Century Regional Developments, a move that would have given TPG Newbridge a 5.7% stake in PCCW. Furthermore, there were signs that Mr. Li had his eye on buying the Hong Kong Economic Journal, a Chinese-language business daily. This situation was made all the more curious by the fact that there are cross-media ownership restrictions in Hong Kong. (PCCW runs NOW Broadband TV and Internet-services provider Netvigator.) The final act of apparent betrayal came earlier this summer when TPG Newbridge and Macquarie Bank began jostling to empty PCCW of its major telecom and—conveniently for Mr. Li—media assets.

Hours after headlines blared with the news of the impending asset takeout battle, China Netcom issued a cranky statement saying it would not countenance a change in the ownership structure. One could understand the resentment. China Netcom had been promised a stable ownership structure when it paid a rich premium for its stake. Bids to take over substantially all the major assets appeared to violate the spirit if not the letter of the agreement.

But it is also understandable why Macquarie and TPG Newbridge pressed on. PCCW has strong cashflows but heavy debt. According to an estimate by JPMorgan, finance charges will eat up more than half of the \$339 million in free cashflow the broker expects PCCW's fixed-line and mobile businesses to generate in the current financial year. With their deep capital resources, the bidders were in a position to lower the financing charges. Thus for them PCCW offered a better yield play than it could to its current shareholders. A good-enough yield play, according to frequently quoted market sources, to be able to offer up to \$7.7 billion for less than 80% of the assets.

China Netcom was suddenly facing the possibility of a 100% return on a \$1 billion investment—in less than two years. In-



PCCW Chairman Richard Li announces details of financier Francis Leung's \$1.18 billion bid for a stake in the Hong Kong telecom firm.

deed, the potential profit was greater than what China Netcom raised through its 2004 initial public offering. Such windfalls don't happen too often, and deserve at least a rethink of strategy.

The first thing China Netcom executives should have asked themselves was: just how important is PCCW to China Netcom's corporate goals? Hong Kong is a mature, saturated, deliberalizing market whose ultimate consumer base is a puny 7 million. In comparison, China Netcom's Hong Kong-listed vehicle has nearly 90 million fixed-line subscribers in China and saw more than \$11 billion in revenue splash through its coffers last year.

Nor would a sale have likely threatened China Netcom's goal to provide premier broadband services to its mainland customers, and to ensure top-notch "connectivity" with the international world. It is simply old-fashioned—or paranoid—to assume you really need to own the infrastructure to use it. Competitors Hutchison and New World have gained considerable fixed-line market share in the past decade—and they still rent most of their lines from PCCW.

In March PCCW paid more than \$41 million for a 50% stake in China Netcom's privately owned broadband arm, a hopeful sign that the two were finally getting it together on the mainland. But if China Netcom was worried that a change in ownership would threaten future cooperation, the fact is—a change of ownership

was imminent anyway. In an interview with Chinese investigative magazine *Caijing* in the midst of the takeover battle, Mr. Li complained that China Netcom was dragging its feet on the rollout of dual services on the mainland. It was becoming increasingly clear that Mr. Li wanted out. In mid-July, he agreed to sell 22% of his shares in PCCW to former Citigroup Asia chair, Francis Leung. The long-time mover and shaker, who had helped China Netcom list in Hong Kong in 2004, had cobbled together an eleventh-hour bid in an apparently seat-of-the-pants manner. The price of HK\$6 per share was a lot punier than what the other bidders were willing to pay. Still, it was better than the June 16th pre-deal talk closing price of HK\$4.8, and freed Mr. Li up to take up a 50% stake in the Hong Kong Economic Journal. (In late July, Mr. Leung agreed to buy an additional 0.38% stake in PCCW for HK\$4.90 per share.)

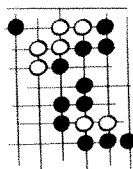
The talk around town, and the interpretation that many newspapers printed as fact, was that Beijing didn't want "foreigners" controlling the telecom infrastructure of China's greatest financial city. Actually, Beijing has never said such a thing. But it's hard to believe that the cashed-up bidders would have been packed off so quickly if China Netcom had to answer to shareholders.

The other possibility is that more personal, psychological or cultural issues hardened China Netcom against the idea of selling out to foreigners. A common criticism of Western business culture is that it is short-sighted, obsessed with the thrill of the deal and breeds disloyalty. But if China Netcom didn't like their ways, they should have opted to fight fire with fire. Opportunistic trades do not have to derail long-time strategies.

If China Netcom were nimbler—and perhaps freer—here's how this story could have played out: When China Netcom saw a few funds cashed up to their eyeballs and hungry for a deal, they could have played on "nationalistic" fears just long enough to extract the highest price possible from the bidders.

Instead, China Netcom torpedoed the possibility of a deal that surely had other minority shareholders jumping with joy. And what ensued is nothing less than Absurdist Theater. What exactly could Mr. Leung bring to the table that the Aussies and Yanks couldn't? It is no surprise that the local press speculated that Mr. Leung is doing China a favor by promising not to sell to other investors, or holding the stake for China Netcom to buy at a later date. Moreover, Mr. Leung has not yet even raised the \$1.18 billion he needs to pay Mr. Li for this stake. Yet it might not be too Herculean a task to raise the money—if some Chinese banks are ordered to cough up the funds.

Mr. Li, meanwhile, comes out of the situation looking pretty cool. When he took over the former Hong Kong Telecom in the dotcom days, transforming a steady if boring dividend provider into a high-risk play, he was skewered in the press. As the son of Li Ka-shing, the richest man in Hong Kong, critics caricatured him as the type of spoiled brat who'd take dad's Porsche for a joy ride, then wreck it. But one can't imagine any of the old guard of Hong Kong's business community (except for maybe Gordon Wu) risking Beijing's wrath in this way. By losing patience with China Netcom and expressing his dissatisfaction in public, Mr. Li has done China's business community a greater service than the legions of businessmen who coddle ill-conceived practices to win Beijing's favor. ■



Kono Taro, LDP Iconoclast

by Hugo Restall

ON SITTING DOWN for an interview with Kono Taro, my first question is predictable enough, on North Korea's latest missile tests a few days before, but his answer is a complete surprise: He immediately launches into a criticism of Prime Minister Junichiro Koizumi's alienation of the Beijing government. Such candor might be unremarkable if this was an opposition leader, or even an LDP back-bencher. But Mr. Kono is not only vice minister of justice and the up-and-coming son of one of the party's most powerful figures, he is also a stalwart ally of Mr. Koizumi when it comes to domestic reform.

Nevertheless, in one recent public lecture he labeled the government's foreign policy "stupid," and called one aspect of immigration policy, over which he has nominal responsibility, "a big bullshit." This ability to stay within the establishment while speaking his mind, along with his combination of Japanese values and Western style, make the charismatic Mr. Kono difficult to categorize.

Dressed in preppy attire—pink button-

down shirt, burgundy suspenders, khakis and loafers—the vice minister looks slightly out of place in the formal surroundings of his palatial office. But the casual look is actually part of the government uniform. The Koizumi administration has inaugurated a "cool Japan" campaign to get office workers to stop wearing suits during the summer so that the cost of running air conditioners can be reduced.

Mr. Kono goes on to explain that the North Korean impasse can only be solved with China's help, but deterioration in relations between Japan and China has made cooperation, and even communication, on this issue impossible. By visiting the Yasukuni Shrine, Mr. Koizumi has violated the deal by which the two countries put the World War II past behind them after 1972. Then Prime Minister Kakuei Tanaka went to Beijing prepared to face demands for war reparations, but instead Mao Zedong declared that the peoples of both nations had been victims of Japan's militarist regime. The blame would be put on the class A war criminals—a fiction per-

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haps, but a very convenient one. That arrangement stuck until the war criminals were added to the shrine and Japanese prime ministers resumed making regular visits. If Japanese leaders return to honoring the deal, he believes, relations with China will go back to normal.

This hardly makes Mr. Kono a Sino-phile or a pushover on foreign policy, however. "The major military threat will come from China," he says. "If China keeps on renovating their military, then we will have to do something about it." He is a long-time advocate of strengthening the alliance with the U.S., at least until China becomes democratic. When controversy flared over U.S. deployment of a nuclear-powered aircraft carrier in Japan to replace the retiring USS Kitty Hawk, he felt so strongly that the ship was needed that he went to Yokosuka, the prime minister's constituency and home to a U.S. naval base, to make his case to the local community. He is open to the idea of developing missile defense, although wary of the potential price tag, and pushed for a permanent seat in the United Nations Security Council long before the Koizumi administration took up the cause.

Mr. Kono is running in the Sept. 20 ldp leadership election to replace the retiring prime minister, but it is largely a symbolic bid—by Japanese political standards he is still an infant at the age of 43, and so the media often neglects to even list him in the lineup of challengers. Nevertheless, the run may prepare the way for future campaigns, and it has allowed him to stump on some of his favorite issues.

Although Japanese schools are still regarded with awe by outsiders, within Ja-

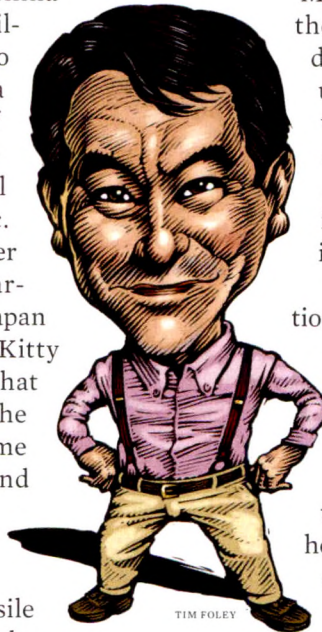
pan there is a recognition that the old system is crumbling and outmoded. Scores on mathematics exams, which used to be the pride of the nation, have been falling, even as many Japanese are recognizing that cram schools and rote memorization do not prepare students for the knowledge economy. Wealthy Japanese are fleeing the public school system in droves and enrolling their children in private academies.

Mr. Kono's solution is to abolish the Ministry of Education and devolve power over the curriculum to local school boards. A voucher system would force schools to compete for students, ensuring better teaching and allowing for innovation.

Faced with an aging population, Japan needs to import workers, but the relatively homogeneous population remains uncomfortable with the idea. As a result, "the front door is closed, but the back door has a lot of holes." As head of immigration of policy within the Justice Ministry, Mr. Kono is pushing for expanding the number of imported workers

to 3% of the population, up from 1.2% today. But at the same time, he insists that they should be required to speak some Japanese so that they can be assimilated into society. And screening needs to be improved so that the public is reassured that the foreigners who are allowed into the country are not engaged in crime.

Meanwhile, the elderly are also at risk. Japan's pension system is in a shambles, and a cautious reform in 2004 only papered over the cracks. The most basic safety net requires all Japanese to pay a monthly premium of about \$100, but non-compliance is soaring, even though about



Japan, the world's most successful communist country, is undergoing the same transition as Poland.

10% of the premium goes toward enforcement. Even the second-tier system, which is also a pay-as-you-go scheme in which employers and individuals contribute, is rapidly losing participants, as anyone younger than Mr. Kono realizes that they will never recoup their contributions. Mr. Kono advocates switching to a system of individual accounts like the U.S. 401(k), but so far he is getting little traction.

Even though a pensions crisis is looming, Japanese politics does not usually encourage raising unpleasant debates until the crisis has actually arrived. This bothers Mr. Kono, who goes around stirring up debate on many controversial topics at the same time. Despite being the son of Speaker of the House Yohei Kono, he approaches his profession like an outsider. Rather than working behind the scenes quietly forming coalitions, he prefers to engage in the marketplace of ideas. Interestingly, however, when asked if he would describe himself as a libertarian, he seems unsure of the meaning of the word.

That stems from frustration with the undemocratic nature of the Japanese parliament. Mr. Kono was shocked when he first won election as an MP in 1996 to realize that the country could manage with such a dysfunctional democracy. Much like in China, he claims, the legislature operates as a rubber stamp for internal decisions made within the ruling party apparatus, which is "just like a puppeteer." The most influential policy maker on tax policy, for instance, is not the finance minister, but the head of the LDP's tax committee, who is unaccountable to the public and does not even have to answer questions. Parliamentarians come and go, while the bureaucrats in the civil service and the party run the show.

That changed, however briefly, in the last few years. Prime Minister Koizumi used the sense of economic crisis and his own popularity to break out and make policy over the heads of the bureaucrats. But the old forces are striking back, undermining Mr. Koizumi's free-market legacy by lamenting a perceived increase in inequality. Mr. Kono counters this not by denying the charge, but instead by arguing that inequality is a good thing. As long as there is a safety net and the possibility of upward mobility, inequality is necessary to the functioning of capitalism and the positive outcome of talented individuals working hard to get to the top.

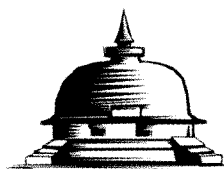
If Mr. Kono sounds like one of the post-communist leaders of Eastern Europe, that's because he believes Japan faces the same transition: "Japan is going through what Poland went through." True, he acknowledges, Japan deserves credit for being "the most successful communist country in the world." But that doesn't make the process of joining the free world any easier. "People who criticize Prime Minister Koizumi for making society more unequal are like the people who voted for the Communist Party in Poland. I think they are making a mistake." The identification with Poland goes back to Mr. Kono's youth, when as a Georgetown University undergraduate in 1984 he studied briefly at Warsaw's Central School of Planning and Statistics and spent a night in jail after trying to interview Lech Walesa.

Many Japanese, particularly of the older generation, are understandably ambivalent about embracing Anglo-Saxon capitalism after the stability of lifetime employment. At a one-day conference held in Tokyo three months ago by the Tuck School of Business, after giving the key-

note address Mr. Kono received a public dressing-down by his former boss, the head of Fuji Xerox Yotaro Kobayashi. Mr. Kobayashi rallied to defend the system Mr. Kono criticizes as communism, and questioned why Japan has to accept what the rest of the world considers best practices instead of going its own way.

While taken aback by this attack, Mr. Kono did not give ground: "It may be an easier world in which to live. But I don't think we have that alternative anymore. If we continue, the entire competitiveness of Japan will go down and we cannot sustain the quality of life of this country."

Asked later if he is worried that the old guard is gaining support from the public, he responds, "They are gaining some support, but the quiet majority are not supporting them. If you watch Tom Cruise's latest Mission Impossible movie, they go to Shanghai, they don't come to Tokyo anymore. That's the reality. We are not the greatest. We have to move quickly, we have to move smarter. Our old system is not fit for today's world. If we try to play with the old rules, we are going to lose, and lose badly. I think a lot of Japanese people feel that. Politics is not moving quickly enough, that's why they are so frustrated." ■



Sri Lanka's Reservoir Of Self-Destruction

by Ashok K. Mehta

ACCORDING TO THE internationally accepted benchmark of 1,000 annual fatalities, Sri Lanka is at war. That number was surpassed just in July and August of this year alone, as fighting escalated between the Sri Lankan security forces and the Liberation Tigers of Tamil Eelam. The latest skirmish, known as Operation Watershed, was sparked over access to water reserves at Maavil Aru, and soon spread to the strategic targets of government-controlled Trincomalee Harbor and Jaffna. Yet both the Sri Lankan government and the Tigers continue to parrot their allegiance to a cease-fire agreement brokered by Norway in February 2002. The agreement—the implementation of which is overseen by the Sri Lankan Monitoring Mission (SLMM) made up of members from Norway, Sweden, Finland, Denmark, and Iceland—is in tatters, but still neither party wants to be seen as the first to walk away.

The international community has done little to help quell the conflict. European countries are playing at botched diplomacy, while neighboring India continues to

refuse a leadership role. Meanwhile, the majority Sinhalese Sri Lankan government remains unable and unwilling to devolve power to the minority Tamils. Thus, when President Mahinda Rajapaksa took office late last year, the Tigers violently marked their exhausted patience using a deadly combination of antipersonnel mines and suicide bombs.

The root of the current conflict at Maavil Aru goes back three decades, to when the Sri Lankan authorities built a water reservoir for government-sponsored Sinhalese settlements in the Trincomalee district. Fighting over control of the region between the Tigers and Sri Lankan forces began in 1991, during Eelam War II, and wasn't resolved until the cease-fire solidified Tiger control in 2002.

As a condition of the cease-fire, the government agreed to help the region improve its access to drinking water, to be drawn from the Tiger-controlled reservoir. After some negotiation, the plan was

Mr. Mehta is a retired major general of the Indian Army who was involved in five major Indian-Pakistani crises.

for an Asian Development Bank-funded project to disperse water to the entire region, regardless of whether the territory was controlled by the Tigers or the government. Tensions in the region caused multiple delays to the project, and soon the government announced it would go ahead on its own, but only in the areas under its control. The Tigers promptly cut off water access, leaving some 30,000 acres of ripe paddy fields and 60,000 people—mainly Sinhalese—hung out to dry.

This created intense pressure on the government from both the Sinhalese locals and the ultranationalist Janatha Vimukthi Peramuna party. As a result, the government launched Operation Watershed—apparently without allowing the SLMM time to negotiate with the Tigers. Elite forces, supported by Kfir fighter jets, were mobilized under the chief of staff, Major General Nanda Malawarachchi, who positioned himself at the Kallaru army base nearby.

Jaffna may be the cultural and spiritual fount of the Tamils, but Trincomalee, with the strategic wealth of the harbor, makes a natural capital for the Tamil homeland in the northeast. A sudden closure of the water channel together with the spiraling confrontation must be seen against the backdrop of the Tigers' game plan: to create a feint at Maavil Aru, while going for Sri Lankan strike force posts on the southern perimeter of Trincomalee Harbor. The Tigers' plan to strengthen its defenses around Trincomalee was sound and part of its ongoing military strategy.

Preoccupied with its own skirmishes in parliament, New Delhi was surprised that the crisis had spread from Maavil Aru to Trincomalee. So serious was the situation that twice in three days President Rajapaksa briefed Indian Prime Minister Manmohan Singh on the matter. But other than express concern, India did little to help the Sri Lankan government build a deterrent

against the Tigers, as they had promised to do when Indian Foreign Secretary Shyam Saran visited Colombo in July.

The blockade at Maavil Aru began on July 20. The idea was to draw Sri Lanka's security forces into the marshes around the water source in an area heavily mined and covered by artillery and mortar fire. It was a deadly trap. For full two weeks, while all eyes were on Maavil Aru, Tiger leader Velupillai Prabhakaran's gaze was fixed on the town of Muttur.

Unfortunately, the Sri Lankan security force ran into trouble from the start. An antipersonnel mine blasted a vehicle, killing 19 soldiers—the single biggest loss since the cease-fire began. Inching forward through a maze of minefields covered with mortars and guns was both time-consuming and costly. It took three weeks and hundreds of casualties before the blockade was lifted.

The ambush at Maavil Aru was set to capture Muttur and the nearby jetty. The four-day battle for the predominantly Muslim hamlet turned out to be a disaster for the Tigers. Capture of the Muttur jetty and adjoining areas would have given the Tigers a contiguous base stretching from Sampor—already in its possession—to Muttur, with direct access through Koddigar Bay to the main jetty in China Bay. The Tigers would have been happy with the control of Muttur jetty alone. Two weeks earlier, their Sea Tigers had made a second abortive attempt to ram a troop ship carrying 854 soldiers with five suicide boats. An encroachment into Muttur and beyond would have further endangered troop sea movement to Jaffna, no longer accompanied by the monitoring mission. The harbor itself would also have become vulnerable. In the Muttur battle, the Tigers were testing the waters around Trincomalee.

If Maavil Aru was a feint, the operations around Muttur went askew for the Tigers. The Sri Lankan forces gave it back

India has done little to help Sri Lanka build a deterrent against the Tigers as promised.

to the Tigers. The alleged revenge killings of more than 100 Muslims by the Tigers for helping government forces in Muttur will not do their already frayed relations with the Muslims any good. The Islamic political parties, principally the Sri Lanka Muslim Congress, have made a big issue of it inside and outside parliament and charged the Tigers with ethnic cleansing.

Just when everyone thought the water war was over, the Tigers extended it north towards Jaffna, presumably trying to retake it after a failed attempt in 2000. While fighting spread across the northeast, the Tigers fought conventional battles against defended forward positions at Killali and Muhumalai, the two main avenues to Jaffna. While much of the fighting was reminiscent of trench warfare and accompanied by intense exchanges of artillery and mortar fire, the Sri Lankan air force pounded Tiger bases in the northeast. Speaking in government lexicon, the Tigers claimed it was defending itself against Sri Lankan security force attacks around Elephant Pass, a strategic isthmus linking Jaffna Peninsula to the mainland, which was lost to the Tigers in April 2000.

Attached to the escalation strategy were political as well as military objectives. Already isolated from the political process, the Tigers have been extremely upset at the European Union, which in June slapped the terrorist tag on them. Maavil Aru was an expression of this resentment. It was also

reflected in their obstinate demand that three of the EU countries—Sweden, Finland and Denmark—be removed from the SLMM by Sept. 1. That would leave Norway and Iceland in the mission. Norwegian peace envoy Jon Hanssen-Bauer told the BBC in August that the EU ban on the Tigers was a setback for the peace process.

While the Tigers failed to make any gains on the ground in Jaffna and Trincomalee, it has put the dormant peace process in a tailspin, forcing the co-chairs of the peace process into fire brigade mode. The Sri Lankan security forces, on the other hand, won a tactical victory by breaking the water blockade.

Away from the battlefield, the Tigers' opposition to the peace process was marked by the assassination of another left-leaning liberal Tamil, Ketheesh Loganathan, who was recently appointed deputy head of the multiethnic advisory committee. They also launched an unsuccessful suicide attack against the outgoing Pakistani High Commissioner, a reprisal for that country's supply of military hardware to Sri Lanka. As India will only supply defensive equipment, Pakistan and China have become the main sources of tanks, aircraft and guns. The militarization of Sri Lanka is complete.

Clearly Sri Lanka is headed on a path of self-destruction. And India, the key stakeholder and regional power, won't—perhaps can't—do anything about it. ■



REVIEWS



**THE KING NEVER SMILES:
A BIOGRAPHY OF THAILAND'S
BHUMIBOL ADULYADEJ**

by Paul M. Handley

Yale University Press, 512 pages, \$38

Reviewed by GRANT EVANS

PAUL HANDLEY, AN American journalist, thinks public figures should go around glad-handing people with smiles plastered on their faces in the manner of U.S. politicians. If they don't, then they must have sinister or untrustworthy intentions. Mr. Handley spends 450 pages documenting what he sees as the underhanded attempts by the reigning "unsmiling" Thai king to establish himself as a modern absolute monarch, a *devaraja*. Thus the supercilious title of this book.

Despite Mr. Handley's own intentions, his biography of King Bhumibol Adulyadej succeeds in engrossing the reader with the complex personality of the Thai king and his long and eventful life. He emerges as a deeply conservative figure culturally, socially and politically. This is hardly surprising. But it is the king's uniquely Thai spin on that conservatism which makes his life so fascinating.

The king recently celebrated his 60th year on the throne with a gala that enthralled Thais, but probably galled Mr. Handley. The hyperbole that permeated this event and often surrounds the monarchy in Thailand offends Mr. Handley's

Mr. Evans is a professor of anthropology at the University of Hong Kong and the *École française d'Extrême-Orient*. His next book is entitled *The Last Century of Lao Royalty*.

egalitarian values and his "Western rationality." Indeed, the book pivots on an old-fashioned polarity between the "rational" West and the "mystical" East with its ritualistic mumbo-jumbo.

In the opening chapters we are asked to reflect on how a boy born in the U.S. in 1927 and brought up as a child in "rational and egalitarian" Switzerland could possibly end up presiding over arcane rituals such as a plowing ceremony to encourage fertility in the land. Mr. Handley's presentation of this is confusing, to say the least.

He seems to want his readers to believe that the future king is somehow not really Thai because of his love for things European and his knowledge of several European languages, rather than applauding his cosmopolitanism. On the other hand, what to make of Mr. Handley's claim concerning the influence of Swiss rationality? In the 1930s, Switzerland was ruled by religiously and linguistically distinct cantons, and only gave the vote to women decades after they were enfranchised in Thailand. This state of affairs seems to have made no impression on the young prince at all. In fact, the future Thai king was not all that different from many other important Asian leaders who studied in the West and enjoyed their sojourns there, but refused on their return home to take Europe or the U.S. as their model for the future.

The Thai absolute monarchy was ready to jump when it was given a firm push into constitutional rule in 1932 by an elite group of civilians and soldiers frustrated by the Crown's inability to cope with the Great Depression. Wrangling over power and prerogatives continued until 1935 when King Prajadhipok, the seventh Chakkri

king since the establishment of the dynasty in the late 18th century, stepped down. The pre-eminent figure in Thai politics then was the army strongman Phibun Songkhram, whose predilection for Mussolini-style nationalism would (arguably) shape the fundamental contours of Thai politics for decades to come. Bhumibol's older brother Prince Ananda, aged 10, was named the new king, but was not crowned until 1938. Eight years later, King Ananda died under mysterious circumstances, and King Bhumibol unexpectedly found himself on the throne.

Mr. Handley's hostility to the Thai monarchy is plain throughout the book, and his discussion of this sad affair is typically jaundiced. All attest that the two brothers were very close, and there is no evidence that the 18-year-old Prince Bhumibol coveted the throne—quite the opposite, in fact. Without advancing the investigation at all, Mr. Handley leaves insinuations dangling in the air, as he does on many other occasions. The palace initially recorded the death as an accident, but this was quickly swamped by self-serving allegations, made by the likes of Phibun, that leftists murdered the king. In no time the case was irretrievably muddled, rendering it insoluble and leaving suspicion to fester on all sides.

In 1946, the 18-year-old king inherited a throne enfeebled by the antimonarchist rule of Phibun, who had made the military into a powerful political institution. King Bhumibol returned to Switzerland to finish his studies, and when he came back to rule in December 1951 with his new Queen Sirikit he was immediately confronted with a Phibun-led coup. The general and his cro-

nies made it very clear to the young king where power lay. At this time the power of the military was being bolstered by the Cold War and massive U.S. support, which would continue for the next two decades.

Surrounded by a group of old princes who provided the king with advice, the palace set out to rebuild its power and prestige, and in particular to build solid links with the army. In 1957 these efforts paid off when royalist Field Marshal Sarit Thanarat carried out a coup against Phibun and sent him into exile. Since then the palace has done everything it can to bind the military to the king.

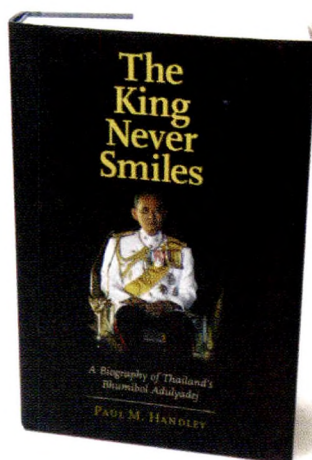
The king's round of "archaic royal rituals," as Mr. Handley likes to call them, was of course his primary responsibility as a constitutional monarch. Through these acts, royalty symbolized the political and cultural unity of the nation. That legitimacy is created by deliberate acts seems to puzzle Mr. Handley, who finds it hard not to see ritual as "irrational" and therefore its practice cynical. Dragging out

another old cliché, Mr.

Handley claims that only the "superstitious" peas-

ants really fell for this. One wonders then what he makes of the hordes of urbanites who flooded the streets of Bangkok for the king's 60th anniversary in June. That these rituals strike a deep chord across Thai society is clearly beyond Mr. Handley's imagination, despite his years as a journalist there.

In its opening pages the book introduces traditional ideas of kingship to the reader, that of the righteous Buddhist king, a *dhammaraja*, and the Hindu idea of an absolute king, the *devaraja*. These ideas are found in various contexts in Thai culture and are often alluded to in the king's ritu-



als. It is hardly surprising that the country's cultural storehouse is drawn on to project an idea of the good society. It is another thing altogether to suggest that the aim of King Bhumibol is to re-establish such a kingship. Mr. Handley repeats these terms *ad nauseam*, never missing an opportunity to remind his reader of the allegedly devaraja or dhammaraja aims of King Bhumibol.

Naturally, throughout the 1950s and 1960s the palace was primarily interested in strengthening and consolidating its position in Thai society and not very concerned with democracy. The escalating Vietnam War nearby and the "communist challenge" made the military seem the best way of ensuring social stability. At no time was the palace in a position to challenge the successive military regimes by itself. The king's dissatisfaction with the results of military rule, its corruption and bureaucracy, finally came from his ever-deepening understanding of Buddhism and his search for some "Asian way" of development.

He was not alone in this quest. The king had become intensely involved in rural development projects and was seeking new directions. What was needed, he said, was "wisdom and intelligence coupled with honesty without any thought for financial gains. Anyone who wants to make money had better resign and go into business." His attacks on capitalism and greed seemed to echo the leftists, but were informed by Buddhism.

On reflection, it is no surprise to find a king advancing a premodern-inspired critique of capitalist modernity. Yet, the king's appeals to social and natural harmony, simplicity, and morality were paradoxically radical and conservative at the same time. Reflexively, such views aligned him with the forces of order rather than disorder, and in the early 1970s accounted for the king's zigzagging between support

for the military and support for reform. This contradictory trajectory of the king's thinking and actions, which would become even more marked over time, should have been the focus of Mr. Handley's analysis. Unfortunately, he strains to compress each maneuver by the king into a simplistic model of the devaraja.

The chapters on political turbulence in Thailand between 1974-76, and on the impact of the 1997 financial crisis, find Mr. Handley at his analytic best. The palace's cautious support for the toppling of the military dictatorship in 1973 won it wide acclaim. But the ensuing social and political turmoil, combined with the communist revolution in Indochina during 1975, would soon thrust the palace back into the arms of the military with its support for a rightist coup in October 1976. Mr. Handley writes:

It was the synchronicity of all these things, the insurgency, his health, his son and the succession, frustration with capitalism and rural development, abandonment by allies, and the communist takeover of neighboring states—which propelled King Bhumibol's and Queen Sirikit's panicky descent into an unapologetic, violent conservatism, leading ultimately to the Thammasat [University] massacre. The fall of the Laotian monarchy in December 1975 was the final straw.

The 1997 financial crisis brought old and new money to its knees, and threatened many of the palace's investments. While the king inveighed against greed and called for self-sufficiency, his economic managers were scrambling to save the foundations of the king's largesse. But the contradictions in palace discourse and practice were mirrored across Thai society, with the crash dramatizing just how much the country had changed as it was swept into a globalized world.

Mr. Handley holds the king responsible for the sorry state of Thai democracy.

Mr. Handley also has some important remarks on the uses and abuses of the *lèse majesté* laws in Thailand, dramatized most recently when supporters and opponents of Prime Minister Thaksin Shinawatra threatened each other with lawsuits. The bickering made a mockery of the law's intent and highlighted once again that its clarification is long overdue.

Typically Mr. Handley overestimates the political power of the monarchy. But as in all constitutional monarchies, the Thai king is strictly constrained. Stepping onto the political front stage is always precarious. When he does so, as in the famous scene in May 1992 when the world witnessed two opposing generals on their knees before the king during his intervention to stop an escalating crisis, for Mr. Handley it is too little too late and its ulterior motive is the strengthening of the king's hand. He claims the king "consistently undermined the development of other permanent institutions," such as political parties, and holds him responsible for the sorry state of Thai democracy. In a strange mirror image of royalist discourses where the king is credited with all that is good in the land, here he is responsible mainly for what is wrong.

Mr. Handley seems to realize that his prejudices have got the better of him when, after criticizing the quality of the king's paintings and jazz music, he says that the point is not to be "uncharitable" but to criticize palace hype. It is not clear what Mr. Handley's artistic qualifications are, but surely in a biography these rather atypical pursuits of the king would normally draw more sympathetic treatment. There is no evidence that the king considers himself especially talented, but being a king and a jazz musician has ensured him

a place in jazz encyclopedias regardless of the palace publicity machine. The king's active enjoyment of art and his public and private performances of jazz add yet another intriguing layer to his life.

The book has its inevitable chapters on the various members of the royal family and their travails—much of which is gossip—and the number of claims prefaced by "it is said" crowd out the known facts in the manner of the tabloid press, rather than the Yale University Press. There is little attempt to evaluate such claims, or even the nature of gossip. It is surely a paradox of royalty that some of the most ardent gossips are royalists themselves. Indeed, one might argue that royalty should only start worrying when the gossip stops, because that will signify that nobody is interested.

But it does pertain to the crucial issue of succession. Even with his elegant, charming third wife whom he married in 2001 and who bore him a son in 2005, Crown Prince Maha Vajiralongkorn remains unpopular. He is overshadowed by his enormously popular, unmarried younger sister, Princess Maha Chakri Sirindhorn, and the king has made it possible for her to succeed him. The issue hangs like a dark cloud over the Thai monarchy.

If, as Mr. Handley claims, King Bhumibol's aim has been to establish himself as some kind of revamped absolute monarch, then the king has surely failed. In the last five years Thai politics has been dominated by billionaire Thaksin, who is the king's opposite in every respect. Mr. Handley is right to argue that the King's vision is a state ruled by Buddhist principles. But when the king lectures his people on self-sufficiency—"If one is moderate in one's desires, one will have less craving. If one has less craving, one will take less ad-

vantage of others. If all nations hold this concept... without being extreme or insatiable in one's desires, the world will be a happier place"—he sounds more like a forest monk than a devaraja.

**FAST BOAT TO CHINA:
CORPORATE FLIGHT AND THE
CONSEQUENCES OF FREE TRADE:
LESSONS FROM SHANGHAI**

by Andrew Ross

Pantheon Books, 336 pages, \$27.50

Reviewed by PETER WONACOTT

AT THE TURN of the 21st century, China was making its mark on the global economy, leaving behind the deep poverty of the past. Glitzy Shanghai and the sprawling factory towns of Guangdong province were obvious signs of this transformation. But it also occurred in more obscure places, such as industrial parks that only a few years before had been fishing villages or pig farms.

The village of Doumen, for example, whose economic mainstay was growing sugarcane and bananas, became host to the Xin Qing Science & Technology Industrial Park. Located just outside the Special Economic Zone of Zhuhai, today Doumen produces mobile phones and computer games on the thinnest of margins. Among the multinationals that have set up shop there is Flextronics, the world's largest contract manufacturer and an expert at finding the cheapest and most efficient ways to get its products to the global market.

What lures Flextronics and other MNCs to China is a grand three-way bargain. Companies get affordable employees—en-

try-level workers from technical schools or sleepy factory towns. The local government gets foreign investment, a gateway to the global economy and—once the tax holidays pass—a slice of factory revenue. Meanwhile, workers get training and a real-life symposium on how to scale the salary ladder by hopping from job to job, company to company. It's "win win win," as they say.

So who loses? Well, for one thing, those jobs weren't exactly homegrown. Most are transplants from other places—North America, Europe and China's Asian neighbors. And, for another, other countries' competition with China may be changing the rules of the global trade game—and not necessarily for the better.

How China has wooed foreign capital, jobs and technology is the subject of Andrew Ross's lucid and engaging look at modern trade from the middle kingdom. From the start, Mr. Ross doesn't mince words about how the country has come to dominate the outsourcing contest. "The real problem," he writes on the book's first page, "is that China is playing host to the largest, and most corrosive, environment for offshore labor in the global free trade economy."

This is not a new argument. In the quest for global jobs, critics say, China cheats. It unfairly extends special tax breaks, gives subsidies for water and electricity, and denies workers the basic right of unions independent of the government. To boot, an undervalued currency has made China's products cheaper for overseas buyers in recent years.

But Mr. Ross's book doesn't bash China from afar. He moves to Shanghai and then Suzhou to view up close this miasma of manufacturing muscle. He speaks with expatriate factory managers, listens to the official pitchmen of China's industrial parks and talks with China's workers, including those in the younger generation who align themselves more with China's

~ Mr. Wonacott is a reporter based in New Delhi for *The Wall Street Journal*. He reported from China from 1994-2005.

China is playing host to the most corrosive environment for offshore labor in the global free trade economy.

strategic modernization than a company's effort to boost its bottom line.

On several levels, from the micro to macro, the book is an attempt to gauge China's position in the world economy—what has shaped it and why it may be disrupting progress toward a more level playing field. The book is timely given the recent failure of key countries, including China and the U.S., to reach an agreement on global free trade. Mr. Ross strikes a good balance between his critical views of China and his understanding of those who want to do business there.

What Mr. Ross receives from his close-up perspective is predictable, though. This is a Hobbesian world where companies, officials and workers collide and play off each other. On the positive side of the ledger, the jockeying has shaved pennies off production of everything from toys to computer chips. Once foreign investors show up, they can usually count on local officials to take care of them, because doing so helps spur economic growth and burnish career prospects for those in the Communist Party hierarchy.

But the rush to China has some side effects beyond lost jobs. U.S. officials have been among those alarmed at eroding controls over U.S. technology and concerned whether restricted goods are winding up in China anyway.

Meanwhile, as Mr. Ross learns from grumpy foreign factory managers, coming to China may not be all it is cracked up to be. Chinese engineers are still not on par with other developed countries in Asia,

including India, while rising salaries are eating into thin margins. One of the book's insights is to show how well aware Chinese workers are of what's going on in the global economy, and how China may not be the last stop in the outsourcing chain. "These days no one owns his job," laments a Chinese software engineer at an Indian technology company.

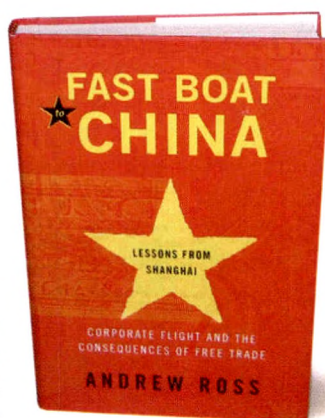
That is the book's bottom line, whether Mr. Ross intended it or not. The silent backdrop to the book is the American worker,

who has ironically lagged behind his Asian counterparts in recognizing that few jobs are safe in this new economic era. Whether that is fair, and whether there's anything to do about it, are questions Mr. Ross takes up with varying degrees of success.

The book does show how China's game plan flouts free trade principles. For sure, Mr. Ross could've dwelled on egregious examples of China's abusive labor and

trade practices. But he avoids diving into China's sweatshops, which aren't easy to get into anyway.

Instead, Mr. Ross takes aim at sophisticated technology companies. While none of the characters introduced are too memorable, Mr. Ross does illustrate the outlines of why China has succeeded in drawing so many foreign companies and jobs to its shores. In addition to tax holidays, cheap land and lax environmental and labor standards, Chinese officials often bend over backwards to accommodate investors. Some have been known to build roads, bridges and rail links at the behest of foreign investors who want to get their



products to the global market faster.

Given China's massive market, it's hard to imagine outside measures that can stem the tide of investment. Mr. Ross recommends that the U.S. counter Beijing's trade-distorting policies by imposing a U.S. tax on corporate flight and offering rewards for companies that stay put. Yet the details of these disincentives and perks are left vague. In any case, Beijing isn't about to overhaul policies that provide millions of new jobs, upward mobility, and more and more people whose economic interests are tied to a strong state hand.

Meanwhile, the U.S., with a Draconian antidumping regime and billions of dollars in subsidies provided to farmers at the expense of poorer countries in Africa, isn't entirely defenseless or blameless in the trade arena, either. The same goes for Europe and Japan, too.

In the end, by dissecting how China has built up its global advantages, Mr. Ross seems to puncture a larger myth. Can trade be fair as long as governments are free to set their own investment rules? Perhaps not.

"When all was said and done, China, like other nations in the offshore market, was in the business of buying jobs," Mr. Ross writes. "Once the investors were there, they expected governments to fill the jobs with the right people, at the right price."

ISLAMIC LAW AND CRIMINAL JUSTICE IN ACEH

*by the International Crisis Group
Asia Report No. 117 - July 31, 2006
Available at: www.icg.org*

Reviewed by JOE COCHRANE

THE REHABILITATION OF Aceh, which lost 177,000 people to the December 2004 tsunami alone and over 10,000 more to the separatist war,

is one of the most intriguing projects Asia has seen in decades. However, Aceh's future is suddenly in doubt. Government policy passed in 1999 has allowed for the application of Islamic Law, or Shariah, making Aceh the only province in Muslim-majority Indonesia legally entitled to do so.

The issue, however, is not so much the law itself, but how it's implemented and enforced. The Acehese face harsh punishments—including public floggings for drinking alcohol, gambling or having premarital sex. In addition, the behavior of the radical "vice and virtue" patrol—which inexplicably began enforcing Shariah in the weeks after the tsunami and has become the most feared and hated group in the province—clearly shows things are not going well.

The growing controversy has posed some tough and uncomfortable questions that government officials in both Aceh and Jakarta have yet to answer: To what extent will the drive for grassroots Islamization affect the secular government and security forces? How is it affecting reconstruction efforts and healing Aceh's traumatized society? What influence will the Aceh experiment have on attempts by radical Islamic groups to impose Shariah throughout Indonesia? Fortunately, those questions and many more are answered in this important report from the International Crisis Group, which cuts through the morass and provides a detailed account of Aceh's Shariah controversy, including its current problems and what might happen next.

Two of the main arguments made by supporters of Shariah in Aceh are, first, that there's a historical precedent to it, and second, that the pious Acehese demand such a law. Neither is true. The Acehese are considered the most devout

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Donor nations must ultimately explain why Taliban-style enforcement was allowed in Aceh.

Muslims in Indonesia, but there's been no public outcry for Shariah in recent years. Islamic judges back in the 17th century did mete out formal justice, but it was a mix of Shariah and customary practices. With the establishment of Dutch administrative control in the late 19th century, the administration of criminal justice was handed over to colonial courts.

During the independence movement of the late 1940s, the report notes, founding Indonesian President Sukarno made tacit promises to the Acehnese that the province would be based on Islamic principles—but that and many other promises to Aceh were later broken. His successor, Suharto, made it clear through policy and legislation that Aceh would not be considered special, meaning no Shariah. By the 1980s, with armed fighting intensifying, “Aceh became less defined by its efforts to establish Islamic law than by the conflict between the [Free Aceh Movement] and the Indonesian military,” the report says.

When the tsunami struck the west coast of Sumatra, few could have foreseen that the war would end 19 months later, with Jakarta and the Free Aceh Movement, or GAM, signing a peace agreement in August 2005. But the giddiness and optimism about the peace process and the strides toward rebuilding villages and towns are now being tainted by the *wilayatul hisbah*—popularly known as the Shariah police.

The group, comprised of arrogant young men with suspect knowledge of Islam, has been terrorizing the province, in particular preying on women and the poor. Their behavior is as outrageous as it is illegal, pulling women off motorbikes and out of hotel lobbies and arresting them for not wearing headscarves, breaking into homes and offices without warrants, or making lewd

sexual references to women wearing Western-style clothing. As the report notes, well-intentioned officials tasked with expanding Shariah are instead creating “a religious bureaucracy committed to its own expansion; a focus on legislating and enforcing morality; and a quiet power struggle with secular law enforcement that may have long-term implications for both the security sector and legal reform in Aceh.”

There are also serious implications for the rest of the country. Indonesia is the world's largest Muslim-majority nation, but it's held together by a secular government and a state ideology, called Pancasila, that promotes multicultural and religious harmony among its hundreds of ethnic groups and Christian, Hindu and Buddhist minorities.

Radical Islamic groups and conservative political parties, stymied time after time at the polls by more than 100 million moderate Muslim voters, are resorting to overheated rhetoric, violence and backdoor tactics to compel Jakarta to impose Shariah across Indonesia. Radical clerics such as Abu Bakar Baasyir, a convicted terrorist, are traveling the country seeking grassroots support. They seem to be gaining traction. As the report notes, at least 22 provincial district governments have enacted regulations inspired by or derived from Islamic law.

In recent years, radical Muslim groups have become increasingly open about their desire to emulate Iran and Saudi Arabia. At a recent anti-Israel demonstration outside the U.S. Embassy in Jakarta, protestors wore fake suicide bomb flak jackets and recruited fighters for a jihad. A previously unknown group in West Kalimantan province claimed to have already dispatched hundreds of bombers to kill American, Is-

raeli and Australian citizens, and held a press conference in which they threatened to blow up every McDonald's in Indonesia. Government and police officials, apparently fearing that they would be labeled as un-Islamic, said and did nothing.

Back in Aceh, officials from at least two provinces have visited to study how Shariah is being implemented. "I think a lot of people are looking at Aceh as kind of a laboratory," said Sidney Jones, ICG project director for Southeast Asia, warning that "once you start on this path, there's a dynamic toward increasingly conservative applications" of Islam.

For all the information and insight the report provides, however, there are two areas where it falls short. The first one is why former President Abdurrahman Wahid, a respected Islamic cleric and outspoken critic of Shariah in Indonesia, agreed to its inclusion in a special autonomy bill for Aceh in 1999. The report glosses over the issue, saying the decision was based "less on popular demand than on an assessment by the Jakarta and Aceh political elite of what would mollify a population embittered by years of conflict, human-rights violations and economic exploitation." But the Acehese may question whether any member of the country's political elite would ever act in the oil-and-gas-rich province's best interests, given recent history. Senior GAM officials claim Shariah is a ruse adopted by Jakarta and the hated Indonesian Armed Forces to divide the population, and have vowed to campaign for its removal during upcoming elections.

Secondly, and perhaps most importantly, the report didn't explore whether Shariah is even legal under Indonesia's secular constitution. Past parliaments have rejected moves to make the country an Islamic state, but somehow managed to allow Shariah in an updated Aceh autonomy law, passed in July. Ms. Jones points out that dozens of lawmakers in Jakarta are

questioning Shariah's constitutionality, as is at least one group of Acehese citizens. However, given the corruption and incompetence within the judiciary—not to mention the sensitivity of the Shariah issue—it's unlikely the Supreme Court will have the courage to strike down the law. The issue will likely continue to fester.

President Susilo Bambang Yudhoyono won a landslide election in 2004 on a platform of a secular, democratic Indonesia, but has inexplicably dodged the growing debate about Shariah in Aceh. Donor nations, which are pouring billions of dollars into the province, have also been quiet. But if the situation deteriorates and they continue to do nothing, the donors—specifically those involved in the U.S.-led war on terror—may ultimately have to explain to their taxpayers why they allowed Taliban-style law enforcement to grow in Aceh. The Shariah issue is complex and still unfolding, but the ICG report goes a long way in putting this important issue back in the spotlight.

**LOCALITIES AT THE CENTER:
NATIVE-PLACE, SPACE, AND POWER
IN LATE IMPERIAL BEIJING**

by Richard Belsky
Harvard University Press,
334 pages, \$45

Reviewed by PAMELA CROSSLEY

WITHIN THE SPAN of one professional lifetime, a revolution has occurred. Closer examination of economic practice across Eurasian history is showing that, in fact, there is nothing much behind the conventional assumption of an East/West dichotomy. Capitalism in China, Japan, India or Holland was always recognizably capitalism, whether manifesting itself in a caste system, a Confu-

Native-place lodges played an essential role in translating provincial interests into imperial policy.

cian hierarchy, or a Protestant monarchy. At the organizational and even cultural level, industrialism in all societies looked generally the same. Contrary to the conclusions of Weber and his followers, there is little evidence that the imperial state in China sat athwart economy and society, or prevented the emergence of innovative, profitable and even private trends.

Richard Belsky's study of the "native-place lodges" in Beijing—the *huiguan* known to every student of early modern Chinese history and the *tongxianghui* that still thrive in some cities today—allows us to see how, from the 15th century on, these classically "Chinese" institutions were part of a flexible and efficient system for the redistribution of labor, expertise, capital and political influence in early modern and modern China. The lodges, which were primarily for merchants, landowners, and (particularly in Beijing) officials, were meeting points at which sojourners reinforced old ties, enjoyed their native cuisine and forged new partnerships.

Superficially, the book recalls the glory days of the Harvard East Asian Monographs (of which this is number 258) in the 1960s and 1970s: A true monograph based on dense research, but framed by a clear and fair discussion of existing scholarship, comparative issues and a conclusion suggesting the significance of the subject. Mr. Belsky's study manages, in the best traditions of the series, to use an engaging case study to illuminate varieties of socially generated forms of management and political action in modern China, as well as to better document the sources of modern China arising from Chinese soci-

ety—as opposed to the motives of the Chinese state itself.

The middle chapters of the book provide concrete information on practically everything that can be known about Beijing's lodges of that era. Architecture, floor plans, garden scenes, lodge economies, membership and staffing are serially investigated. Their relationship to China's early modern commercial development, population expansion and migration is described. Rituals and festivals as means of consolidating the lodge as an organization and tying it to its culture of origin are reviewed. The lodges are also shown to have been essential to urban peacekeeping, participating as they did in the practices of mutual responsibility. Their roles in all these realms, Mr. Belsky reasonably suggests, paralleled the roles of large corporate lineages and of guilds, or *gonghang*.

On the elementary level, it is easy to see the significance of the lodges: They were by definition dedicated to facilitating the migration of managers and their labor forces, the transfer of credit and capital, and the persistence of cultural and genealogical affiliation. As Mr. Belsky points out, the great scholar Ho Ping-ti established long ago the concrete connections between patterns of migration and the establishment of the lodges. Sichuan province, for instance, which was a Ming and Qing period destination of massive migration, primarily from the east and south of China, had by far the most lodges of any province. Conversely, Jiangxi province, which ranked high among the densely populated and commercially developed regions exporting people and capital during the same period, was represented by the greatest number of lodges established across the empire. Lodges allowed certain localities a political, fi-

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nancial and cultural reach that made them small empires within the larger one. But Mr. Belsky (following, as he acknowledges, William Rowe) infuses his discussion with a modern sensibility, investigating the role of the lodges not only in the efficient distribution of expertise and capital, but also in the construction of modern identities, layers of loyalty, and the flexibility to adapt to profound transitions of imperial, national and regional power.

Paradoxically, the most intriguing passages in the book are also to some degree the most frustrating. Mr. Belsky's hypothesis—that lodges were the critical centers of political discussion, alliance formation, and organization as the empire weakened and nationalist movements arose—sounds right.

In Beijing, particularly, the lodges had a distinctive history of catering more to the population of aspiring officials from the provinces than to traveling merchants. During the high period of the examination system and official preferences, the lodges would have had an essential role to play in the translation of provincial interests into imperial policy. In theory, therefore, they should have played an important contributing role in forming the regional political alliances that created a successor state to the empire.

Mr. Belsky looks for evidence that this occurred, and finds plenty to suggest that it did. For instance, the Beijing and Tianjin lodges of Anhui province, it seems, were wellsprings of funding for the remarkable power base that native-son Li Hongzhang helped forge after the Taiping Rebellion. Mr. Belsky quickly moves on to Kang Youwei and the origins of the Hundred Days Reform movement of 1896-98, finding the lodges involved in the organizational meetings behind the protests. Finally, he shows—indirectly—the role of the lodges in Sun Yat-sen's attempts to consolidate a political base for himself in Beijing after

the fall of the empire.

Through all of this, Mr. Belsky manages to outline an important hypothesis on the origins of civil action in transitional China, but goes no further. He or others will have to give it substance and place it in the developing story of popular political participation during the late imperial era.

**SINGAPORE: WEALTH, POWER
AND THE CULTURE OF CONTROL**

by Carl A. Trocki

Routledge, 211 pages, \$100/\$33.95

Reviewed by GARRY RODAN

CARL TROCKI OFFERS a refreshingly different look at Singapore's colonial and postcolonial history, emphasizing important continuities in the city-state's history of authoritarian rule and the struggles involving its Chinese-educated and ethnic Chinese majority. His book also makes the most theoretically explicit statement yet that social conflict is the decisive force for change.

For Mr. Trocki, a professor of Asian studies at Queensland University of Technology, class friction was the key dynamic that shaped modern Singapore, with control over the opium trade and the system of labor organization being two fundamental aspects. However, he takes the legacy of precolonial social structures seriously in his explanation of the limits and possibilities of elite rule. His approach is also empathetic to the losers of these struggles and cognizant of the analytical importance of explaining their defeats. Consequently, the diminished power positions of local capitalists and the working class are afforded

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It wasn't just working class, Chinese-educated masses, but also local Chinese capitalists that Mr. Lee sought to neuter.

special attention and significance.

The complex ethnic mix of forces important to the struggles over economic and social control throughout Singapore's history poses challenges for class analysis. Mr. Trocki appreciates this complexity, detailing much of it in the book. However, his principal focus is on how the different ethnic groups have been involved in, and affected by, the struggle to establish and shape capitalist development. Therefore, whereas writers like Mervyn Wynne, Leon Comber and Wilfred Blythe saw Hokkien-Teochiu tensions in the 19th century as "doctrinal influences" imported from China, Mr. Trocki argues that the root cause lies in the competition over control of pepper and gambier plantations. Similarly, the fragmentation of Chinese secret societies into small-scale criminal gangs is traced by Mr. Trocki to their being squeezed out of revenue farms, the coolie trade and pepper and gambier agriculture between the middle to late 19th century.

The two points most powerfully made in this book relate to his class analysis but are not reducible to it. The first is the observation that the limited institutional penetration and social neglect of the colonial state had long-term political ramifications. The second is that the recent championing of Chinese cultural values by the ruling People's Action Party contradicts its own historic role in the marginalization of social forces and interests associated with Chinese culture.

Mr. Trocki argues that due to both convenience and a lack of political will on the part of colonial authorities, many of the collective organizations of immigrant communities assumed a vast array of social and political roles. British rule in Singapore was "largely indirect and

decentralized as a matter of necessity" given the unwillingness to invest in police forces and other infrastructure. The British relied, for instance, on voluntary collaboration from Chinese triad associations, Malay chiefs who exerted authority over trading communities, and other networks to control the rapidly expanding Chinese population. In the 19th century, Singapore-born Chinese merchants organized powerful *kongsi* organizations to ensure the wealth and welfare of their families and clans over the long term, providing for education, burials, support for the destitute and other social benefits.

Yet Mr. Trocki explains that there were unintended political consequences from leaving the masses to their own welfare and organizational devices. The influence of the Singapore Chinese Chamber of Commerce (SCCC), labor unions and assorted student and cultural organizations expanded in the first half of the 20th century. Chinese schools also represented the largest and most vibrant education sector in Singapore by the 1940s. While the authorities selectively engaged with the SCCC, it was largely through other organizations that the postwar struggle for independence was conducted. This was a reality that Lee Kuan Yew and his faction in the PAP had to contend with, the ultimate solution to which was harsh responses to independent, critical voices.

Despite Mr. Trocki's emphasis on class, he contends that the division between the Chinese-educated and the English-educated "lies at the heart of Singapore's social fabric and has been one of the dynamic themes that binds the 19th-century history of the place to the 20th century." In advancing this argument, Mr. Trocki submits an especially unflattering contrast

between the English-educated middle-class nationalists aligned with Lee Kuan Yew and Chinese-educated nationalists:

It was the Chinese-educated, some of them communists, who had organized the labor unions in Singapore, fought secret-society thugs hired by the government, stood against police batons and, where necessary, gone to jail. None of these were things that Lee himself would ever have done.

Significantly, once the PAP was in government and Mr. Lee's faction in control of the executive, it was not just the organized working-class, Chinese-educated masses but also the local Chinese capitalists that Mr. Lee sought to politically neuter. On this point, Mr. Trocki makes a valuable contribution toward a better understanding of how early and strategically Mr. Lee thought about curtailing organizational structures outside his control. Nevertheless, his observations could still benefit from elaboration. For instance, what were the "left-leanings" of such business people as Tan Kah Kee, Lee Kong Chian and Tan Lark Sye that formed the basis of links between sections of the Chinese-educated business elite and the Chinese-educated mass organizations in the late 1950s and early 1960s? Was it only economic nationalism that provided any basis for extending the shared language and cultural agendas of these different social forces?

Irrespective of the answers, Mr. Trocki is right to emphasize how the tag of "Chinese chauvinism" was used expansively by Mr. Lee to suppress legitimate debate about Chinese language and culture. Having played so decisive a role in the social, economic and political marginalization of the Chinese-educated, there is thus considerable irony in Mr. Lee's championing of Confucian values during the 1990s—a point to which Mr. Trocki's book gives

acute expression. In this respect, the book's target is as much the PAP's version of Singapore's modern history as it is professional historians who may have paid inordinate attention to elite colonial and postcolonial actors.

In the latter chapters of the book, Mr. Trocki offers a wide range of observations about the tensions unfolding in the present political economy of Singapore, including the growing dependence on new forms of immigrant labor. However, the real strength and originality of this book lies in the attempt to decipher the underlying nature and causes of social conflict over the last two centuries. Mr. Trocki highlights the surprising continuity, maintaining that the real legacy inherited from the British was not a parliamentary system but "130 years of autocratic rule by an unresponsive bureaucracy and an ambitious and exploitative economic elite." For Mr. Trocki, contemporary power structures in Singapore have much deeper roots than are generally recognized.

THE CHINESE CULTURAL REVOLUTION AS HISTORY

Edited by Joseph W. Eshrick, Paul G. Pickowicz and Andrew G. Walder
Stanford University Press,
382 pages, \$65/\$24.95

Reviewed by JONATHAN MIRSKY

THIS COLLECTION OF essays from an academic conference, edited by three leading China specialists, is surprisingly exciting. The eight authors are mostly graduate students and six are Chinese, some of whom graduated from mainland universities and learned to do real research from the editors of this book. All eight have escaped from the straitjackets of previous assumptions about the Cul-

*“Comrade Li: Please accept this 300 yuan.
I hope it can help you to some degree. Mao Zedong.”*

tural Revolution, assumptions on which older students of China, including myself, were to some extent raised.

One of these assumptions was that competing local factions between 1966 and 1976 were divided by class—that is, the economic and political have-nots were taking their revenge on those with different interests or status. Early Cultural Revolution analysis was often based on interviews with refugees in Hong Kong and scattered publications; the editors call this “remarkably thin” evidence, although it established the reputations of many pioneering academics.

Nowadays, the editors point out, instead of mountains of conclusions, there are vast ranges of genuine evidence: big runs of documents, memoirs, speeches, biographies and many witnesses willing to talk. What emerges is that there were different Cultural Revolutions all over China.

Take the eye-opening essay brilliantly titled by Elya Zhang as “To Be Somebody: Li Qinglin, Run-of-the-Mill Cultural Revolution Showstopper.” In early 1973, Li Qinglin, an ordinary primary school teacher in a Fujian backwater, wrote a 1,700-word letter to Mao complaining of the wretched conditions endured by his son who had been “sent down” to labor in the countryside. “I am now helpless with nowhere to turn ... so I have to take the liberty of ‘appealing to the emperor,’” he wrote.

Many ordinary people wrote to Mao, few letters reached him, and in the 10 years of the Cultural Revolution he replied to just one supplicant: Li Qinglin. Mao sent him 300 yuan and a note: “Comrade Li Qinglin, the issue you wrote about seems

ubiquitous around the country and needs to be solved as a whole. Please accept this 300 yuan. I hope it can help you to some degree. Mao Zedong.”

As Ms. Zhang says, calling Mao “emperor” may have appealed to his vanity, and with his blunt exposé of a big social problem—the exploitation of the sent-down youth—Li got Mao’s attention. Mao ordered a special meeting, chaired by Zhou Enlai and including two Gang members, to consider the matter, and before long Li was a national superstar, lecturing, hectoring, interrupting, and upstaging everywhere he went. Huge audiences, some in Beijing, noted down every word he uttered.

But, and here is one of the reasons this book is so valuable, “even a letter from Chairman Mao was not an instant ticket to political stardom.” After Mao’s death and the arrest of the Gang of Four, in October 1976 the superstar became a “black hand.” Now the Fujian officials had their revenge. Trotted around Fujian to hundreds of meetings, Li was insulted and beaten. Accused of many things he hadn’t done, he was imprisoned for life and released only in 1994. He died in 2004.

Li’s sons, including the one sent down about whom Li had appealed to Mao, also suffered for years. The Cultural Revolution, Ms. Zheng rightly says, “was not simply a decade of madness. There was a kind of brutal calculation to it all.” And that spirit endured, she suggests: “People still used blanket political labeling, demonization and denunciation, struggle sessions, and forced confessions.” “When,” she asks poignantly, “will the aftershocks of the Cultural Revolution finally cease?”

In another pathbreaking essay, Dahpon David Ho dismantles the usual narrative focusing on Red Guards and their cam-

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paings of "smash, burn, fry and scorch." The destruction was certainly horrendous: In Beijing, 4,922 of the city's 6,843 "officially classified historical sites were damaged or destroyed from mid-August to September 1966." But in that same August, marauding Red Guards, bent on wrecking the Confucius Temple complex in Shandong, were driven off. Officials, townspeople, and peasants banded together to defend it in the face of the Maoist command to destroy the Four Olds.

What emerges from Mr. Ho's painstaking and comprehensive account is a "deeper story of protection and resistance whose surface has scarcely been touched." The usual explanation for any things or people who were rescued—and it always seemed unlikely to me—was that Zhou Enlai had done the saving, just as, Mr. Ho suggests, the Gang of Four "is vilified for every calamity." Zhou was indeed important in such rescues, but so were the Central Committee, State Council, and Central Military Commission, whose Circular in March, 1967 forbade "sabotaging state property," and commanded that "management and protection of cultural relics and books must be strengthened; under no circumstances may they be wantonly disposed of or destroyed."

Zhou was involved in this rescue, but so were Chen Yi, Chen Boda, Qi Benyu, and Li Xiannian. No one blamed Red Guards specifically, but it was explained that what must be saved were the products and contributions of the working people of China. This was the very explanation I heard in China in 1972 when I asked how it was that so many so-called "feudal" buildings and objects had been preserved.

At the local level, Mr. Ho writes, archaeology had been turned upside down, with many precious objects being buried. "Concealment became the predominant mode of preservation." In many instances, he adds, "Verbal support for 'old cul-

ture' was possible mainly because local pride still appealed to Red Guards." Mr. Ho's conclusion, like Ms. Zhang's in her chapter on continuing vilification, is poignant: China's cultural heritage has been a long struggle since the May 4th Movement. He points to the escalating demolition of old Beijing in the face of "modern city planning," with what the editors call "post-Mao shopping malls and skyscrapers, McDonald's and Starbucks."

RESTLESS SOULS:

REBELS, REFUGEES, MEDICS AND MISFITS ON THE THAI-BURMA BORDER

by Phil Thornton

Asia Books, 220 pages, \$11.54

Reviewed by ILARIA MARIA SALA

AT THE BORDER between Thailand and Burma, there is a war going on. Everyday, soldiers and civilians die as victims of a brutal regime that kidnaps, tortures and kills its citizens. It is a David-and-Goliath battle that pits a Karen army of 20,000 poorly armed rebels against nearly 500,000 government troops. As they fight in the inhospitable jungle, characterized by ambushes and landmines, and plagued by malaria, monsoon rains and the lack of food and medicine, the world looks the other way, sullen and incapable of any intervention.

The conflict between the Karen minority and the Burmese military dictatorship is the world's longest civil war, one of the many gaping wounds left open in the aftermath of World War II and decolonization. Largely the outcome of a British postwar betrayal, it is yet another example of a botched attempt to close the chap-

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*"Thais say it takes three car tires to burn a Burmese....
Migrant workers have fewer rights than street dogs."*

ter on colonial history, only to leave in its wake a trail of blood and misery.

In Burma, as in Indonesia, the Philippines, Malaysia and other Asian territories occupied by the West, the invading Japanese army in the 1930s and 1940s tried to portray itself as a liberator—a harbinger of that pan-Asian prosperity that claimed to free the continent of its colonial yoke. Many national liberation movements were lulled by this Japanese rhetoric, only to realize too late their own folly and the sheer brutality of a Japanese occupation. The initial message sounded convincing, and for a while fooled a number of anticolonial leaders.

This is why Burman nationalists, including General Aung San (father of Aung San Suu Kyi), originally collaborated with the Japanese. The Karen, on the other hand, in an attempt to secure their own independent state, sided with the British.

In 1948, shortly after the war, Gen. Aung and his followers gained independence and the British pulled out, leaving control of the entire territory to the Burmese nation, a postwar construct that ignored the aspirations of many non-Burman people, including the Karen, Shan, Mon and others.

The postwar years were thus characterized by internal strife, among the different political factions as well as those ethnic groups that refused to become subjugated minorities. Then, in 1962, all political development was suddenly blocked by a military coup led by Ne Win, which has kept the army in power to this day.

Journalist Phil Thornton takes no shortcuts in writing about this struggle: He spent five years living in Mae Sot, south-east of the Thai-Burma border, "trying to make sense of the Burmese military dicta-

torship and the people of Burma."

Mae Sot is today "the unofficial headquarters for Burmese opposition groups and activists"—a normally restless border town whose wealth was founded on the smuggling of jade, drugs and people. It is surrounded by refugee camps and inundated by spies, aid workers, photojournalists and the odd adventurer in search of a quick emotion. Many of the Burmese refugees had fled their homes after the 1988 student demonstrations ended in bloodshed—some were just high-school kids back then, joining the demonstrations in the fervor of youth, and have been paying the price in fear and exile ever since.

Here, slowly and patiently, Mr. Thornton collects the pieces of a complex puzzle, resisting the temptation to reduce the Karen's struggle to a simplistic, emotional sketch. In this way, while giving a moving portrait of those who have maintained an admirable humanity in spite of the hardships life has thrown them, Mr. Thornton also explores through chilling description how guerrilla warfare has hardened some of its leaders, or how the fight often exerts too heavy a toll, leading its combatants to the allure of a drug-induced oblivion.

One of the biggest challenges Mr. Thornton faced in researching and witnessing this story, however, was in maintaining a disinterested objectivity, or what he calls—quite diplomatically—"the constraints of modern journalism." Thus, while he is able to gain the unprecedented trust of many activists, medics, villagers and workers, he finds himself at a loss to explain why the suffering of the murdered and maimed is "not news."

Some of the people Mr. Thornton meets have indeed grown weary of the steady trickle of journalists into the coun-

try. Looking for a good story to sell, they would rush in and out, without taking even the minimal precautions of ensuring that their interview and photo subjects will not end up suffering for the access they grant. What is going on in Burma, Mr. Thornton explains, is a complicated story, one that needs patience and dedication to be understood. It must be verified and retold, and cannot simply be dealt with in a couple of sensationalistic pieces.

Restless Souls, then, is the story of the Karen struggle, but also that of a people who lost everything when they were children, who endured the unthinkable and have become hardened to the constant risk of hunger, death, booby traps and deportation. It is the story of medics who have dedicated their lives to their people's suffering—such as the renowned and admired Dr. Cynthia Maung (winner of the 2002 Magsaysay Award, Asia's equivalent to the Nobel Prize, and called by some "Burma's Mother Theresa")—and who continue to treat patients under the most testing conditions imaginable.

The book also details how, once in Thailand, some of the refugees still lacking proper status are at the mercy of callous employers who exploit them ruthlessly and without fear of reprisal. Writes Mr. Thornton:

Arkar asked me if I knew what Burmese workers say when they see smoke over Pro Phra district (south of Mae Sot)? I shook my head and said no. "Another Burmese worker is being burned. Thais say it takes three car tires to burn a Burmese. The police don't care. Migrant workers have fewer rights than street dogs."

This is a book with a mission. Mr. Thornton incites the world to "take responsibility and force the Burmese regime to release their political prisoners and hand over the country to its people." By describing what

is happening inside northeast Burma and along the Thai border, he has written an account that is eye-opening, urgent and indispensable.

**DISCOVERING NATURE:
GLOBALIZATION AND ENVIRONMENTAL
CULTURE IN CHINA AND TAIWAN**

by Robert P. Weller
Cambridge University Press,
198 pages, \$70/\$28

Reviewed by CHRISTINE LOH

AT A TIME when controversy was still fresh over the Three Gorges Dam—having displaced well over a million people and whose long-term ecological impact remains unknown—national leaders in China embarked on the \$125 billion South-North Water Diversion Project. Designed to redirect water from the Yangtze River to the drying Yellow River, it was yet another example of a massive water project necessitated by economic development and population growth. Droughts in northern China are now the norm, while the once-mighty Yellow routinely fails to reach the sea.

Apart from needing an adequate water supply, the challenge in China is also to ensure that the water is clean and safe. China's State Environmental Protection Administration reported that 75% of China's urban water is unsuitable for human consumption—records show some 30,000 children in China die annually from diarrhea due to drinking contaminated water. Around thirty percent of the river water is unfit for agriculture and industry. High pollution levels are to blame.

As China's fast-paced development puts

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Localized protests coupled with a monolithic authority inhibits organizations from becoming nationally significant.

enormous demands on the nation's air quality, in many parts of the country the situation has become severe. Pollution levels in cities such as Shanghai and Guangzhou often exceed by multiple factors those of the most polluted cities in the U.S. and European Union. The cost to human health from air pollution accounts for up to 3% of GDP in China; in the country's largest 11 cities, approximately 50,000 people die prematurely and 400,000 suffer from chronic respiratory problems every year as a result.

How do the Chinese look at nature and its protection? Robert Weller reminds us in *Discovering Nature* that the idea to dam the Three Gorges was first proposed by Sun Yat-sen in the early years of the Republican period. Nature was seen by both the Nationalists and the Communists as something to be understood and controlled for production and human benefit, unimportant as an end in itself. This also explains the insatiable market in China for exotic animals as food: Endangered or not, their sole purpose is to serve human needs.

Mr. Weller surveys three decades of environmental movements in China and Taiwan to understand how a people's conception of nature influences when and how they take environmental action—and the cultural and social resources that shape this action. He describes the instrumentalist Chinese view, still widely held throughout rural areas, and the extent to which the global environmental discourse—a view increasingly held among urban elites—has affected this tradition. Many NGOs focusing on environmental issues, including animal rights and wildlife conservation, have emerged as a result.

While China and Taiwan today are structured very differently politically, Mr. Weller sees similarities in how envi-

ronmental protests have been organized in both countries. The most striking is the frequent use of blockades, which Mr. Weller believes are a prevalent form of protest because, for the Chinese, they carry a certain legitimacy: People believe they have a moral right to obstruct harmful practices, particularly if the obstruction comes without physical violence.

Mr. Weller provides an extensive discussion across multiple chapters about the rising incidence of protests in China, including environmental protests, and explains that they take place because the government has created a space for them. China today has a reasonably elaborate environmental bureaucracy, with established mechanisms for legal protests, such as writing letters to the authorities or calling special hotlines to raise complaints. There have also been riots against toxic spills and over the illegal location and practices of industrial plants. These protests may indicate a decline in political control, but for Mr. Weller they also reflect a government more willing to tolerate popular feedback. As long as the protests remain "local" and do not threaten the fundamental political structure of the one-party state, they can be accepted.

And this is ultimately part of the problem in China. For Mr. Weller, the localized context of protests—a disjointed interaction of "multiple locals and globals," as he calls it—coupled with the monolithic authority of the central party, inhibits grassroots organizations from gaining any meaningful foothold and significant scale.

Taiwan, where there is political space for civil society to play a watchdog role, and indeed to enjoy the democratic right to vote a government out of office, doesn't have the same problem. Nevertheless, Mr. Weller is disappointed that the Taiwanese have

adopted global environmentalism along with its wilderness aesthetics (expressed through enthusiasm for nature parks) that he sees as "a dehumanized idea of nature" departing from Chinese cultural roots.

Mr. Weller tells readers that he initially set out to find a unique "alternative environmentalism" that may be emerging in the Chinese experience and that could be studied as "a variation on the theme of local resistance" to the global environmental movement. He believes the "universalization" of current Western environmental discourse is limiting and hoped to find in China and Taiwan an alternative, which he admits he failed to discover.

His conclusion, that the localized ideas "remain diverse and malleable" and are "available if we need them," seems rather obvious. Alas, he doesn't take the argument any further, which will be disappointing for readers looking for further insight or policy recommendations.

**THE BACKROOM BRIGADE:
HOW A FEW INTREPID ENTREPRENEURS
BROUGHT THE WORLD TO INDIA**
by Seetha Parthasarathy
Penguin India, 224 pages, Rs 375

Reviewed by PAUL VANDENBERG

BUSINESS PROCESS outsourcing to India is now a \$5 billion industry, employing over 300,000 people in call centers and back-office roles. While much has been made about its drain on Western economies, here finally is a book that focuses on the Indian experience.

Since its inception in the mid-1990s, the sector has experienced constant and rapid change. In the early years, the challenge was in convincing executives that high-quality outsourcing was a feasible alternative. Now other factors are at work.

Rapidly rising wages are eroding India's economic advantage, leading to competition from other low-cost sites, notably in China and the Philippines. Indian firms are responding by adding value with more complex functions such as stock-trends analysis and portfolio-risk assessment for investment banks.

Here too, however, India faces stiff competition from advanced sites in Malaysia and Singapore. But one clear advantage is the ability to combine outsourcing with India's strength in software development: An information-technology company might, for instance, work with an existing call-center client to develop faster or more analytical software for processing caller requests or problems.

Not all executives are convinced that moving up (and out) of call-center work is the right move, however. Having built their fortunes on this segment of the market, they would rather look to time, cost and quality improvements as the means to stay competitive. Nonetheless, the question is generating considerable existential angst within the sector.

Another key challenge is information security, notably for credit card and banking clients. Access to information may tempt employees to siphon off funds for their personal use. While there have been few actual cases of this occurring, opponents of outsourcing have nevertheless seized upon the rare instances to create a public-relations nightmare. Tighter monitoring and stiff penalties would be the main solutions here.

Now, finally, after years of growth, the sector is beginning to center around some key larger players, though the direction of consolidation remains difficult to pinpoint.

Mr. Vandenberg is a New Delhi-based consultant and writer whose recent book *The African-Asian Divide* (Routledge, 2006) examines the success of local Indian businesses in Kenya.

Domestic bank employees are up in arms. India, it seems, is getting a taste of its own outsourcing medicine.

IBM's purchase of Daksh eServices in 2004 seemed to herald a new era of FDI-inspired buyouts. However, Indian firms have also gone global themselves, buying up out-sourcers in the U.S., United Kingdom and Ireland, setting up near-shore operations and establishing low-cost facilities in the Philippines and Eastern Europe. They are also moving to tap the domestic market, with bank employees at home up in arms over attempts to outsource their jobs. India, it seems, is getting a taste of its own medicine.

Along with the challenges faced by executives and entrepreneurs in developing the industry, the book also goes behind the scenes, providing a glimpse into the working lives of those twentysomethings and middle-aged housewives who do the actual processing. It's a high-stress job because these "agents"—as they are called—face an unending queue of callers, work odd hours and are constantly monitored.

Turnover rates are as high as 50%, adding substantially to recruitment and training costs. Stress is only one factor causing turnover, however: Employees also leave for higher education, personal reasons (often marriage) and better prospects. Firms are scrambling to control these factors, offering to pay for part-time studies or organizing social activities. Some are experimenting with "no poaching" policies. Meanwhile, recruiters are becom-

ing more selective, having learned that young people, mostly those from wealthier or entrepreneurial backgrounds, often see processing jobs as temporary; recruitment is thus beginning to target towns and smaller cities in search of people intent on building a career.

In addition to direct employment, the sector has spawned a network of "ancillaries"—transporters, caterers and recruiting firms—as the outsourcers increasingly use outsourcing themselves to reduce costs and focus on core activities. The book illustrates how housewives have been become (wealthy) multiclient caterers, and drivers have gone on to establish transport companies.

Overall, this book is an easy and enjoyable read, written by a business journalist with a nose for a good quote. It relies on the knowledge, opinions and the experiences of business people to tell the story, without belaboring a single view of what the industry is and where it should be headed. However, while strong on anecdotes, it could have provided a clearer outline of the sector as a whole: Several tables of basic industry statistics would have been useful, as well as a list of some key companies, their founders, size and specialities. These are minor quibbles, however, about a book that succeeds in providing an in-depth look into a rapidly expanding industry. ■

THE TRAIN FROM HEAVEN AND HELL

by Ron Gluckman

MY HEAD WAS pounding as we ascended the soaring Himalayan peak. All around, people were struggling to adapt to the lack of oxygen. In my arms I cradled my dying companion, a veteran of scores of Asian treks. He flickered in and out of consciousness before finally succumbing to the effects of the altitude. My iPod was dead.

Plenty of other digital devices ceased functioning on the first regular service train roaring through the clouds to Tibet. No one really knew what to expect, since we were pioneers, riding rails where they had never stretched before. Bags of crisps popped. Pens leaked. And people didn't fare much better. Cleanup crews scrambled to keep sinks clear as passengers fell ill.

The whole operation had an air of last-minute improvisation, which was not surprising given that the July 1 inaugural journey was months, even years ahead of previous estimates. Food and drink were in short supply. Stations were closed or still under construction. Then there was the advance misinformation, prompting huge ticket lines and price gouging. As so often is the case in China, political goals and self-congratulations came ahead of safety concerns and common sense.

Still, whatever political hay was being pitched off track, on board there was plenty of excitement as we scattered enormous herds of shaggy yaks grazing on the

spectacular Qinghai Plateau, or hurtled through the Tanggula Pass at the ear-popping altitude of 5,028 meters. Passengers marveled at views previously seen only by rugged adventurers: snow-capped peaks, the sprawling Qiangtang Grassland and birds roosting along the dazzling blue shores of Qinghai Lake.

"This is a historic achievement and a proud moment for the Chinese people," enthused He Yunsong, a teacher from Hubei province, echoing the Party line. "Nobody believed we could build this train."

Engineers have faced numerous daunting challenges since starting the project in 2001. The new track covers 1,120 kilometers to Lhasa, mostly at altitudes higher than small planes usually fly. Murray Hughes, editor of *Railway Gazette International*, termed it "the world's most ambitious railway construction project."

Nearly 1,000 kilometers of rail runs at 4,000 meters or higher, and 550 kilometers of track tops permafrost. Chinese engineers devised ingenious processes to mitigate land shifts when the ground melts and re-freezes. One method plants picket-fences of huge tubes that feed ammonia underground, keeping permafrost on ice. Elsewhere, tracks are elevated over unstable ground, creating dream-like runs where we floated over vast expanses of grassland that stretched to snow-sprinkled mountains on the horizon.

On the train, passengers crowded windows to marvel at the devices. That it all actually worked seemed to justify the \$4.2 billion price tag. The big question, though, is for how long. Reports of cracks in tracks and bridges have already begun to appear in Chinese media.

∞ *Mr. Gluckman is a writer based in Phnom Penh.*

Bags of crisps popped. Pens leaked. And people didn't fare much better. Cleanup crews scrambled to keep sinks clear.

At the outset, Beijing was making a massive wager on untried technology in a most taxing environment. But few have grasped the extent of the wager. With railway, there is miniscule margin for error, especially in an environment where wind rages at 50 miles per hour and temperatures plunge to minus 30 degrees. If that wasn't danger enough, the area is prone to earthquakes—a magnitude 8.1 tremor hit in 2001.

Sadly, innovation along the ties didn't translate into much inside the train. Luxury cars with observation decks and elegant dining rooms are promised to come from several hospitality firms. Until they arrive, however, the carriages remain the same as those used all across China. That means no showers, and only squat toilets for most passengers, especially in hard-seat class.

The complaints about onboard discomfort are nothing to compare with Tibetan views about the train. I was in Tibet as construction started five years ago, and was startled to find that public opinion had already hardened against the project. It is hard to imagine any part of the world, especially an area so isolated, that would oppose better transportation links. But, as advocates right up to the Dalai Lama note, nobody consulted Tibetans about whether they even wanted a train.

"The railway line itself is not a cause

of concern for the Tibetan people," a spokesman for the Dalai Lama told me. "How it will be used is the main concern." Khedroob Thondup, nephew of the exiled Tibetan leader, was more explicit: "This is the second invasion of Tibet."

Beijing tried to blunt criticism with propaganda, branding opponents as terrorists, while pro-Beijing Tibetan officials called the railway a new "Road to Heaven."

People in Lhasa, and around Tibet, were uniformly wary, fearing that the train will only bring more Chinese workers to, as one guide said, "take our jobs and our houses, just like they already did our land." Everybody told me the same, except the Chinese who,

as predicted, filled the train. I found only a handful of Tibetans on board. And none were working on the train or at Lhasa's massive station, except for those polishing the marble floors or sweeping up outside.

Whether the railway will bring prosperity to Tibet remains to be seen. What is certain is that Lhasa will be swamped with tourists, mostly Chinese. Quotas recently had to be imposed on crowds at the Potala Palace, former home of the Dalai Lama. "Enjoy your time in Lhasa now," said Nema, practically the first Tibetan I met, at Lhasa station, where we were queuing for hard-to-find tickets. "Next time you come," he added, "it might not be Lhasa anymore. The train changes everything." ■



Blessed Relief

PASSING THROUGH DELHI'S shambolic international airport in the wee hours of the morning recently, TT was heartened to see the notice of renovation reproduced at right. Yes, it will be a big relief when the new bathrooms are ready for use. We won't be standing around waiting, hopping from one foot to the other, however. Somehow our confidence that anybody in India can "make it happen" is just not that great.



Froggy Goes A-Courting

EVERYONE KNOWS THAT after the rains, frogs get randy. Apparently in India farmers have noted this correlation but reversed cause and effect—in order to hasten the monsoon's arrival, they try to entice the frogs into conjugal bliss. And naturally the way to do so is to hold frog weddings! The Times of India reports that thousands of villages of drought-stricken Assam are staging the *bhekulir biya* ceremonies in meticulous detail, from the bridal procession to the tea and sweets at the reception. To get the frogs in the mood, the villagers even collect lots of water from nearby ponds. When the amphibians start leap-frogging, will the heavens open?

Halal Intoxicants?

WHAT A MÉLANGE of different beliefs and cultures we inhabit, and how oblivious

some are to that fact. On a Cathay Pacific flight to Bangkok with final destination Karachi, TT observed how a flight attendant courteously delivered a tasty looking Muslim meal to the elderly, sari-clad Pakistani woman in the next seat. The cabin crew member then politely asked what the lady wanted to drink with her halal feast: "Tea, Coke or beer?"

Flunking Copyright Law

THE HONG KONG Examinations and Assessment Authority is a bunch of intellectual property thieves. An extreme statement? Perhaps. But consider the REVIEW's experience. A year ago the authority requested permission to use REVIEW articles in their exams. That's normally not a problem, but we charge a nominal fee in order to protect our rights. In this case, however, they had already reprinted the article, saying they could not ask for advance permission lest it compromise the integrity of the exam.

And oh yes—could we waive the fee because they have no budget for reprints? We finally gave in and granted the retroactive permission—*gratis*—on condition that the authority never use another REVIEW article in its exams.

Lo and behold, this summer another letter arrived, announcing that the authority has ripped off REVIEW content yet again. And could we please grant them permission, just like before?

This time, the fee is a nonnegotiable HK\$2,000. Perhaps we should also ask the delinquent educators to write 100 times, "We will not violate copyright."

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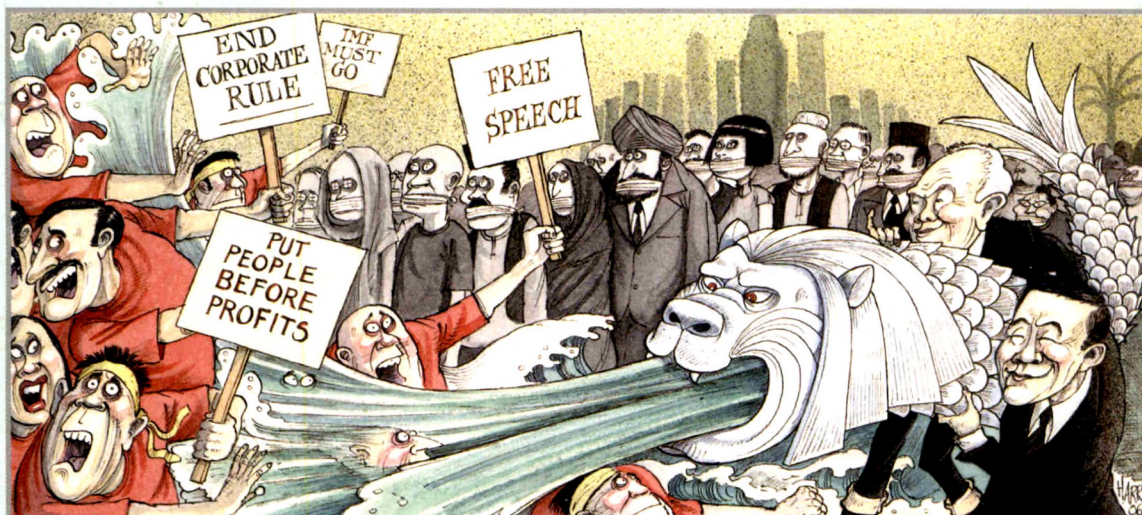
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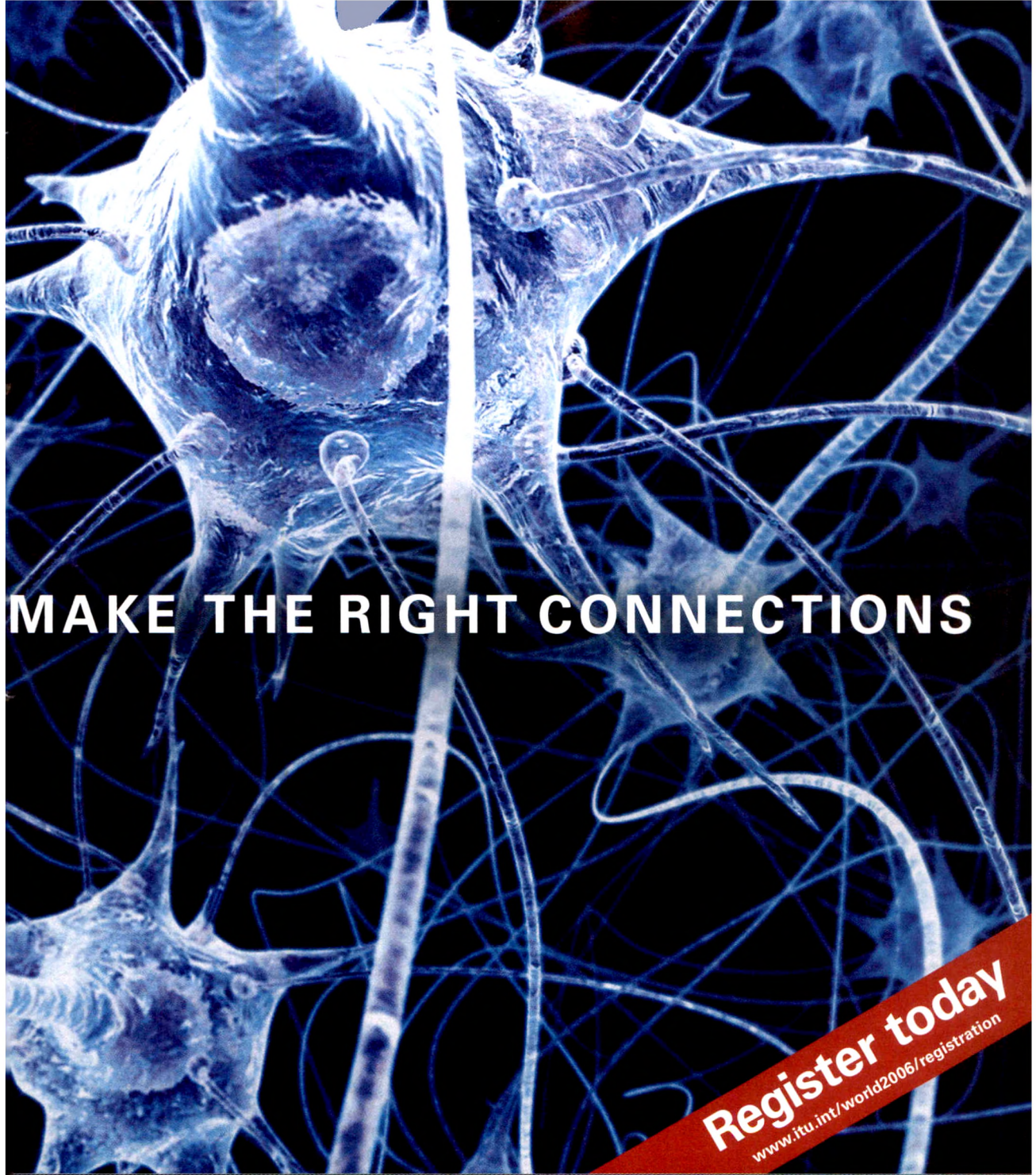
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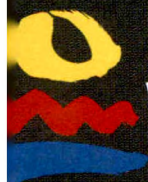


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THE SINGAPOREAN government's recent decision to ban the REVIEW and the defamation lawsuits against us by its two most powerful politicians take us back to a time when the city-state was a poor speck of a country sitting on one of the fault lines of a fractious region. Besieged from without and within, the government of the young People's Action Party resorted to Draconian colonial-era laws to crush dissent. Today, Singapore is an affluent and peaceful society with ample means to protect itself, and its Southeast Asian neighborhood has progressed from confrontation to cooperation. So why is it still using repressive measures against a monthly magazine that employs a total of three full-time journalists and has 1,000 subscribers in the country?

The July article that started this most recent dispute with Singapore, "Singapore's 'Martyr,' Chee Soon Juan," sought to raise a similar question, only it focused on the methods used to silence the leader of the opposition Singapore Democratic Party. We put it to Mr. Chee himself, and he laid the blame squarely on the country's founding Prime Minister Lee Kuan Yew, who now holds the title of "minister mentor."

The ruthless suppression of dissent must be kept up, he said, because as long as Mr. Lee is alive, a new generation of leaders is unable to emerge and distance themselves from his record. Mr. Lee's past actions, which have led to human rights abuses and statist management of the economy, haunt the government. Mr. Chee believes that is the true reason dissidents like himself are hounded: "If we had parliamentary debates where the opposition could pry and ask questions, I think he is actually afraid of something like that."

After the article was published, we received letters from Davinder Singh, a lawyer for Mr. Lee and his son, Prime Minister Lee Hsien Loong, claiming that these sentiments and several other sections of the essay defamed the two men. Mr. Singh demanded apologies, removal of the article from our Web site, and an undertaking to pay damages and legal costs.

We did not comply with these demands, and proposed instead to publish a clarification that the REVIEW did not intend the article to express the defamation alleged by Mr. Singh. After several rounds of correspondence with Mr. Singh, all of which is posted on our Web site www.feer.com, we heard nothing more for 10 days. Then the Singaporean Ministry of Information, Communications and the Arts announced new conditions to be imposed immediately on the REVIEW, requiring us to appoint a legal representative in Singapore to accept lawsuits, and post a S\$200,000 (\$126,000) bond to cover damages from such lawsuits—even those relating to already published articles—if we wished to continue circulating. This order had no basis in Singapore's own law, which stated clearly that such regulations could be imposed only on publications that publish at least weekly or which have been found to have engaged in domestic politics. We have also posted all of our correspondence with the ministry on our Web site.

The timing and substance of this move were in our view no coincidence. It followed hard upon our refusal to apologize and pay damages. Moreover, to sue the REVIEW in Singapore, the Lees would have to serve the papers in Hong Kong, where the magazine is based, since we do not have any employees in Singapore. This means

we could challenge that service and/or the enforcement of damages in Hong Kong.

With Singaporean efficiency, the government bureaucracy leaped into action on the Lees' behalf, imposing conditions with retroactive effect in order to force the magazine to put its head on the block for the Lees to chop off. When the REVIEW refused to comply with these conditions, the Lees proceeded with their lawsuits anyway. This episode tells us much about the use of official power to chill free speech in Singapore.

The Lees' court filings of Aug. 22, which we have posted on our Web site, claim that the REVIEW article carried the message that Mr. Lee Sr. is "unfit for office because he is corrupt." We believe that no rational subscriber to this magazine would read the article in the way the Lees allege. Reporting an opposition MP's claim that a leader's policies may have led to human-rights abuses and the concealment of government errors is very different from alleging he is corrupt. Mr. Lee's probity is legendary; we do not believe that his faults include personal corruption, and it strikes us as fantastical to allege that such an allegation was made by the REVIEW.

The lawsuits also make reference to the section of the article that notes "Singaporean officials have a remarkable record of success in winning libel suits against their critics. The question then is, how many other libel suits have Singapore's great and good wrongly won, resulting in the cover-up of real misdeeds? And are libel suits deliberately used as a tool to suppress questioning voices?" The lawyer claims

that this means that Mr. Lee Sr. "has set out to sue and suppress those who would question him as he fears such questions would expose his corruption."

Mr. Lee certainly has an impressive record of suing his critics, as do other Singaporean officials, but since we don't believe he is corrupt, we could hardly have meant that these lawsuits were intended to conceal corruption. Rather we asked the question, one that is legitimate and in the public interest, whether Singaporean officials have used libel lawsuits as a tool to suppress legitimate criticism.

Even defending oneself vigorously in Singapore can incur punishment. For instance, in a case involving a REVIEW article from 1987, a London queen's counsel vigorously cross-examined the prime minister. After finding for Mr. Lee, the court awarded him aggravated damages in part because the barrister's questions were calculated to "increase the

hurt to his feelings."

Finally, the Lees' lawsuits against us allege that the REVIEW defamed them by referring to the scandal of the National Kidney Foundation and Chief Executive T.T. Durai. We noted that this case was exposed only because Mr. Durai, having prevailed in one defamation case, filed a second against a major bulwark of the regime, Singapore Press Holdings, which he lost. The obvious and legitimate question asked by the opposition is, how many more Durais are there in Singapore officialdom who are getting away with abuses because of the lack of an independent media and a vigorous opposition?

Corruption undoubtedly exists in Sin-



gapore, as the National Kidney Foundation scandal shows, but asserting this is not a slur—no country is entirely free of this taint. The key thing to watch is whether a government uses sunlight as a disinfectant, or sweeps its errors under the rug. Singapore's use of press restrictions and politically motivated libel actions makes us wonder whether its reputation for clean government is deserved. For instance, in July, Minister Without Portfolio Lim Boon Heng encouraged the local media to focus more on good news and stop trying to uncover abuses: "If you want to do investigative reporting, there must be something which is wrong which has not been attended to. I think there are not many issues in Singapore that fall under this category."

Mr. Lim's words reflect Singapore's deliberate program to neuter the domestic and international media. Over its 60 years, the REVIEW has often borne the brunt of this campaign. In a 1995 column for the Independent newspaper, the late Derek Davies, a former editor, recalled that in 1976 Mr. Lee Sr. threatened the magazine with ruin if it commented on sensitive matters. Then in 1985, Mr. Lee confided he had a new plan:

"He told me that he was determined to set things straight with the foreign press before he handed over power to the younger generation," Mr. Davies wrote. "He was drafting a new press law aimed at the pockets of owners and publishers, not editors. If any publication was deemed to be 'engaging' in Singapore's domestic politics, its circulation (and its profits) could be cut to a trickle, while denying it the right to claim it had been banned."

The new law was passed in 1986, and as a commentator noted in the Times of London the following year, there was little doubt what engaging in domestic politics meant: "As a rule of thumb, any article with which Singapore disagrees and which does not carry its views is deemed to be

an interference in its internal affairs." It wasn't long before the REVIEW fell afoul of the stricter standard. In 1987, Mr. Lee sued for libel over its coverage of the detention without trial of Catholic social workers, claiming he was portrayed as intolerant of the church and religious freedom. The government restricted the REVIEW's circulation to a tiny number, and when Mr. Davies withdrew all distribution, it pirated the magazine with the advertisements blacked out.

Sadly, the government's efforts at controlling coverage of Singapore have been largely successful. For local journalists, whose coverage is controlled by the government through Singapore Press Holdings, resistance is futile. And given that Singapore represents an important market for media in the region, many foreign publications are wary of offending the government. Correspondents who want to tackle controversial subjects find that even carefully nuanced articles involve so much back-and-forth with the lawyers that the effort hardly seems worthwhile. When something critical does make it into print, the appearance of a letter from Mr. Singh demanding an apology and damages has in recent years too often resulted in immediate capitulation.

We respectfully submit that balanced coverage of Singapore in the international media requires deeper reporting and tougher analysis of government actions, as well as an occasional opportunity for opposition politicians to speak for themselves without fear of financial ruin. This is one reason for the REVIEW's decision to defend itself against these latest defamation suits.

In this issue, academics Michael Barr and Garry Rodan take on two taboo subjects in Singapore: the racial composition of its educational system and the government's control of the local media. Mr. Barr examines whether Singapore's claim

to be a meritocracy stands up to scrutiny given the striking inequality between the races as shown by the educational advantages enjoyed by ethnic Chinese. Mr. Rodan looks at how the government controls the flow of information for the purpose of protecting and reinforcing the founding myths of the PAP regime.

These articles go straight to the heart of some of the most sensitive issues the Singapore government doesn't want discussed: race, language, religion and culture. These topics are sometimes said to be "out of bounds." As Mr. Lee Sr. once explained, "They are not cerebral matters which we can discuss in a Western salon. In our society, these are visceral matters. People take their religion very seriously. It is extremely dangerous to treat this just as another conversational subject."

Mr. Lee apparently still sees the country he shepherded to independence as fragile and vulnerable. Yet having enjoyed almost 40 years of PAP rule, Singapore has had plenty of time to tame its ideological

and racial demons. If after four decades the society remains so volatile that one can't even discuss sensitive topics openly, the government must have failed in its duty to build a harmonious society.

We don't think that's the case. There is much to admire in Singapore's development under the PAP, and the REVIEW has a responsibility to its readers to provide a balanced view of this record. When honest criticism is forbidden, however, balance is hard to attain. We come back to Mr. Chee's appraisal that the real impediment to Singapore's emergence as a self-confident, pluralist society is Lee Kuan Yew himself. After all his contributions, the minister mentor is tarnishing his legacy with attacks on the REVIEW, the international and regional press, Mr. Chee, and others who pose no threat to Singapore. We believe most Singaporeans recognize this and yearn for a fully free democracy. We look forward to that day, when we hope the REVIEW will circulate in Singapore once more.

H.R.

LETTERS

Abuse of Freedom

HAVING RECENTLY READ the essay "Singapore's 'Martyr,' Chee Soon Juan" in the July/August edition, I was shocked that a relatively respected magazine such as the REVIEW would deign to publish such a poorly researched and biased piece of writing. Assuming the article to be written by an unseasoned journeyman journalist, imagine my surprise to find that it had been written by no less than the editor, i.e., your esteemed self.

In my humble opinion, Mr. Chee has never presented any viable alternative to what he constantly rants against as an unfair political regime, or what he chooses to call a "dictatorship," which has, to my knowledge, constantly held free and fair elections over the past 40 years. A regime which, I might add, has built up possibly the greatest economic miracle ever seen in recent history. It is curious that your magazine has chosen to play up Mr. Chee, who spends more time traveling around the world than he does on home soil, and more time giving lectures to criticize our country abroad than he actually does providing constructive criticism back in it.

I for one am deeply offended by the undertones in the article that insinuate that Singapore is a country devoid of human rights and filled with intrinsic corruption. Clearly, my ability to express my opinions in this open letter indicate my

intellectual freedoms, while we have constantly been rated by world bodies such as the IMF and the World Bank as one of the cleanest countries in the world, with strict laws and transparency on corporate governance and corruption. Your article insinuates that the day Singapore will truly be successful and gains its freedom is the day when Minister Mentor Lee Kuan Yew departs from this world. As a citizen, I think that will be a truly sad day in Singapore's history, for we would not only have lost a visionary and architect of our nation's success, but also a well-respected thought-leader in global politics, one who has been invited by many top corporations around the world to serve as an advisor to their senior management. When politicians such as Mr. Chee are elected into parliament, Singapore's future as a nation will be bleak.

It is ironic that your article aptly displays the dangers of what Mr. Chee terms as "freedom" while simultaneously calling for more such "freedom" in Singapore. For it is such unabashed prejudice and biased writing that may serve to sway the less-informed and undermine the political, economic and racial stability—the foundations of which we have spent years to build.

Gary Chua Sheng Yang
Singapore

Mr. Chee responds: The last time I attended any conference overseas was in September 2005, and I've been in Singapore ever since. My passport was seized in April of this year, and I've been prohibited from traveling overseas. Previously my travels have been to attend conferences for a few days at a time, so I've consistently been in Singapore for more than 90% of the time.

THE FAR EASTERN ECONOMIC REVIEW welcomes letters to the editor sent via fax to (852) 2503-1530, by email to letters@feer.com or by post to GPO Box 160, Hong Kong. Submissions must include the author's full name, address and daytime contact numbers. The REVIEW reserves the right to edit letters for length and clarity.

I have published five books, two of which spell out my ideas for policy alternatives. Both publications were adopted by my party as its manifesto over two elections. Mr Chua probably doesn't know about this because the local media would not give it coverage.

The Thaksin Legacy

COLUM MURPHY'S SEPTEMBER essay "A Tug of War for Thailand's Soul" very much reflects the themes expressed in the just-published Yale University Press book *The King Never Smiles*. After living and working in rural Thailand and Bangkok for several years, I question some of the "factual" data and its interpretation put forward by the books author, Paul M. Handley.

Nonetheless, the constant drive to preserve the Chakri dynasty and popularize the king's sincere efforts to follow the then-kingly principles of dynastic rule is a fact of Thai life. The other fact is that some ambitious Thai politicians have sought to popularize policies somewhat antithetical to those of the king in the rural areas, the most successful being Prime Minister Thaksin Shinawatra. So your story line was very sound indeed.

Something seriously missing in all of this is the enormous attention that Mr. Thaksin devoted to reforming the Thai bureaucracy. This required several years of his effort in order to conform with requirements set by the IMF and supported technically by the World Bank in 1997. Much resented by the bureaucracy, the reforms are resulting in a more rationally designed set of ministries, the use of modernized equipment and increased reliance upon performance-based planning and evaluations procedures.

I am familiar with some of these matters insofar as they affected the Thaksin government's support for implementing the Decentralization Act of 1999. He picked up

on this matter soon after becoming prime minister and steadily supported the major reforms. These are altering the political, development and administrative practices of rural Thailand in ways not well understood among the elite in Bangkok.

Thank you for this observant article on Thailand; the quality and depth of the REVIEW is improving, and your contribution adds to the strength.

James J. Dalton
Alexandria, Virginia

Thaksin's Support Bought

I JUST FINISHED reading the September essay "A Tug of War for Thailand's Soul" and I was a bit unnerved that Mr. Murphy did not get his facts quite straight on the support that Prime Minister Thaksin gained in rural Thailand. The fact is that he bought the support one household at a time, not earned it.

Tim Reilly
Chicago

No, Thaksin's Support Was Real

I ENJOYED READING Colum Murphy's essay on Prime Minister Thaksin but your suggestion that "few in Thailand believe that relations between [Mr. Thaksin and the King] are as amiable as the photograph suggests" is inaccurate. Certainly, most scholars and elites believe their relationship was not amiable, but there are few people in the northeast who would believe so.

In fact, if you suggested that there were some tensions between Mr. Thaksin and the king to any uneducated Thaksin supporter, they would think you were absolutely crazy and would probably become very angry if someone (especially a foreigner) made such a suggestion.

Jason Johnson
Bangkok

Missing Profits

WEIJIAN SHAN'S SEPTEMBER essay ("The World Bank's China Delusions," September 2006) masterfully discredits the claim that Chinese firms are highly profitable. However, a fundamental point, which strengthens his case, is missing from his arguments. Return on assets as calculated using the National Bureau of Statistics numbers includes depreciation. In an investment boom depreciation charges surge. Deeper digging into the official data allows us to calculate the net return on assets, i.e., excluding depreciation. Alas, this number was barely positive in 2005.

Diana Choyleva
London

Who's Driving?

WHAT JONATHAN ANDERSON argues in his September essay "China's True Growth: No Myth or Miracle" is hackneyed to any properly trained economist. The faults of the Asian model, i.e., high savings rate, excessive investment and low return rates, are well-known; while anyone paying attention to China knows that it is not exceptional, vis-à-vis the Tigers. Mr. Anderson tries to deflate China's myth by propounding the idea that China is just part of the growth chain, which began with Japan, then passed on to the Tigers, and subsequently to China and then India.

Nonetheless, Mr. Anderson didn't show any logic behind his perception of such rise and fall in Asian economy, or show us any driving force behind the shifts. One may well ask: why do the Asian economies rise in such a particular order, and not vice versa? Especially, why didn't India succeed before China does? Throughout his article, Mr. Anderson left this essential question unexamined. Instead, he took the working of "Asian growth chain" for granted, arguing that India is the next.

Mr. Anderson deems that size, a nation's population stock, matters. China's oversized population entails its global impact. This is indeed an oversimplified explanation. Population stock matters, while its age structure matters more. Previous studies (David Bloom et al, 1998, 2000) show that demographic transition, namely, a change from high to low rates of mortality and fertility, has been more dramatic in East Asia during the 20th century than in any other region or historical period. As demographic transition sets in, a nation's working-age population grows at a much faster rate than its dependent population, thereby pushing up national saving rates.

When Japan is aging, China benefits from its population dividend, while the Indian demographic transition has just begun. Such population dynamics are pivotal in shaping the chain of Asian success stories. Unfortunately, Mr. Anderson overlooked such a convincing explanation.

Despite the fact that Mr. Anderson is reminding the investors that China is a mundane story, while India is hopeful, he should not advance his ideas at the expense of analytical rigor, to cater to the taste of low-cost-seekers.

Steven Wang
Stockholm

Mr. China's Bullish

READING "CHINA'S TRUE Growth: No Myth or Miracle" by Jonathan Anderson I stumbled over a gross inaccuracy at the very beginning. He says that Tim Clissold, the author of *Mr. China*, portrays China as a house of sand. Did he really read the book? It seems to me that Mr. Clissold believes that the so-called China dream is as solid as rock, in spite of the fact that he was instrumental in losing \$500 million.

Angelo Paratiko
Hong Kong



Singapore's Founding Myths vs. Freedom

by Garry Rodan

THE SINGAPORE government hoped for significant returns when it invested approximately \$85 million to host the September 2006 meetings of the International Monetary Fund and World Bank. And this seemed like a reasonable expectation. After all, the 16,000 delegates represented a captive audience to promote the Singapore's finance and tourism industries.

What transpired, however, was a public-relations disaster for the ruling People's Action Party. Singapore's extensive curbs on political expression were to consume much of the international media attention before and during the meetings.

Home Affairs Minister Wong Kan Seng warned that public protests may "attract severe punishment, including caning and imprisonment." Under Singapore's Public Entertainment and Meetings Act, a security permit from police is required for more than four people to gather in a public place. Authorities claimed that outdoor protests would disrupt local residents and could be exploited by terrorists.

Far from winning new admirers by

hosting the meetings, Singapore's authorities managed to alienate existing ones. Leading American neocon Paul Wolfowitz, now president of the World Bank, slammed immigration restrictions on activists as "authoritarian." Mr. Wolfowitz accused Singapore authorities of reneging on a 2003 agreement to allow attendance of accredited activists, adding: "Enormous damage has been done and a lot of that damage has been done to Singapore, and it's self-inflicted." Belated approvals for 22 of the 27 banned activists to enter Singapore limited—but didn't undo—the damage.

Many international NGOs conducted their activities from the nearby Indonesian island of Batam. Meanwhile, international media attention turned to the attempted illegal march and rally by Singapore Democratic Party leader, Chee Soon Juan, and six others to highlight curbs on freedom of speech, association and assembly. Encircled by 30 police, the protesters were physically prevented from even beginning their

Mr. Rodan is director of the Asia Research Centre and professor of politics at Murdoch University, Perth, Australia.

march from a city park. Without taking a single step they had proven their point and the government's contempt for voices of protest was vividly projected to the world.

Additional limits to political expression in Singapore are imposed through stringent media regulation and frequent litigation by government leaders. None of this is abating. Indeed, this publication was recently banned in Singapore, as editor Hugo Restall explains in this edition. But why does the ruling PAP persist with such tight controls over expression given that it enjoys widespread political support inside and outside Singapore? How can we understand the sorts of PR disasters described above?

Any attempt to answer these questions needs to grasp that suppression of dissent in Singapore is discriminating. The PAP has over the last four decades displayed special anxiety toward certain criticisms and scrutiny, while it is less severe in its reactions to others. In particular, it reacts robustly to questioning of the PAP's governance virtues and the integrity of the political, legal and bureaucratic institutions it has crafted. It is especially protective of two foundational myths of the PAP, which provide the rationale for the ruling party's monopoly of power.

The first myth is that public institutions are autonomous, efficient and administered by a meritocracy. In this construction, the integrity of any institution is directly linked to the character of its officials and vice versa. The second posits that unless all politics is channeled through clearly defined and regulated formal political institutions then Singapore's social and political stability will be at risk. This concept of politics is a compartmentalized and highly regulated one.

However, the veracity of such defining stories about the essence of the regime's character and purpose are impossible to fully ascertain given the constraints on in-

quiry and debate into them. This is not by accident, since if these myths could not hold up to scrutiny then the rationale of the de facto one-party state would be undermined. Insulating these myths from scrutiny may reflect a lack of confidence in the ability of Singaporeans to assess competing claims about key institutions. It might also reflect a lack of confidence in the ability of the institutions to withstand critical scrutiny. Whatever the case, reinforcing foundational myths involves continual vigilance in monitoring and restricting public debate on PAP governance and institutions.

Paradoxically, dissent itself can actually be functional for the promotion and reinforcement of these myths. For instance, the high-profile defamation suits against critics not only impair or punish government opponents. These trials also avail the ruling party of opportunities to articulate the proclaimed attributes and qualities of the governance system. This explains what otherwise appears to be an inordinate scale of resources and political investment devoted by the PAP to such trials.

Similarly, the extensive system of licenses and regulations pertaining to any form of political expression enables authorities to do more than just limit such activities. It provides opportunities for authorities to echo political leaders' notions about threats to social and political order posed by civil society activism, public rallies, Internet Web blogs and other independent political expressions.

PAP sensitivity to scrutiny of key state institutions goes a long way toward explaining why J.B. Jeyaretnam and Mr. Chee have encountered more difficulties than most opposition politicians. They are depicted as engaging in "gutter politics," periodically contrasted for the worse with Singapore's two opposition members of parliament—Mr. Jeyaretnam's successor at the helm of the Workers' Party, Low Thia

The PAP's determination to insulate its foundational myths remains resolute.

Khiang, and the leader of the Singapore People's Party, Chiam See Tong.

In recent decades, Messrs. Jeyaretnam and Chee have consistently probed, questioned and criticized various aspects of the governance system, honing in on the processes accompanying bureaucratic, administrative and political decisions. They have each endured a raft of problems with authorities in trying to conduct political organization and communication—including a string of defamation cases awarding massive damages to PAP leaders. These ultimately resulted in the bankruptcy of the opposition politicians and hence their ineligibility to contest elections.

The most recent demonstration of the difficulties in scrutinizing the PAP's governance claims without being open to defamation allegations by PAP leaders was provided in the run up to the May 2006 general elections. Mr. Chee led an SDP campaign questioning the response time of the government to problems over disclosures and uses of public funds by the multimillion dollar charitable organization, the National Kidney Foundation. Any chance of a robust debate about the performance of the government and state regulatory institutions was blunted following legal suits by Prime Minister Lee Hsien Loong, Senior Minister Goh Chok Tong and Minister Mentor Lee Kuan Yew.

Questioning the associated meritocracy myth has proved especially hazardous for the international media. Examples of this include responses to articles by the International Herald Tribune in August 1994 and Bloomberg in August 2002, respectively seen to imply nepotism in the political rise of Lee Hsien Loong and in the appointment of Lee Hsien Loong's wife, Ho Ching, to the executive directorship of

the government-linked holding company, Temasek Holdings. The IHT was ordered to pay over \$604,000 in total damages, while Bloomberg settled out of court for around \$380,000.

Observations about how the governance system treats PAP leaders was at issue in a \$555,000 defamation suit against the Hong Kong-based Yazhou Zhoukan for publishing comments in September 1996 by Singapore lawyer Tang Liang Hong. These related to a controversy over a prelaunch discount sale offer of condominium units by Housing Properties Limited taken up by Lee Kuan Yew, Lee Hsien Loong and various other members of the Lee family. One of the directors of HPL was Lee Suan Yew, the elder brother of Lee Kuan Yew.

Then Prime Minister Goh's instigation of an investigation into the propriety of the offer and the timing of disclosures by HPL to the Stock Exchange of Singapore, conducted by the finance minister and the head of the Monetary Authority of Singapore, cleared the Lees of any impropriety. However, Mr. Tang maintained that an inquiry conducted by either the Commercial Affairs Department or the Corrupt Practice Investigation Bureau would be more convincing since they were more detached from government. Lee Kuan Yew and Lee Hsien Loong sued Yazhou Zhoukan for approximately \$555,000 for defamation and extracted an apology from the magazine.

Given the frequency with which Singapore's courts have been deployed to quell criticism of key institutions, it's not surprising that questioning the judiciary's independence is treated most seriously. There is no better illustration of this than in the case against the IHT for a 1994 op-ed article in which Christopher Lingle didn't even mention Singapore or its courts by name. He re-

ferred to the use in the region by some authoritarian regimes of "a compliant judiciary to bankrupt opposition politicians." Lee Kuan Yew insisted this was an oblique reference to Singapore and sued the IHT and Mr. Lingle. In the prosecution's determination to prove this point, it documented 76 separate articles from the Straits Times between 1972-94 to establish that government critics had in fact been regularly prosecuted in Singapore's courts. Likewise, in Annex A of the Aug. 22 court filing against the REVIEW, the plaintiffs' lawyers enumerated 22 of the defamation actions previously taken by Mr. Lee since 1965.

Mr. Lee's eagerness to draw the world's attention to such a history and to volunteer that Singapore's legal system was the premier candidate for Mr. Lingle's description might appear puzzling. However, the trial provided a stage for Mr. Lee to assert the independence of the judiciary, to sound a stern warning to others who might want to question this, and to reinforce claims important to Singapore's economic brand, namely that the integrity of the city-state's governance regimes distinguish it within the region.

Yet this strategy is not without contradictions and it faces challenges from political and economic forces. Ironically, one challenge emanates from the increasing use of the courts by Singapore's political opponents to question, counter and challenge the PAP's foundational myths. Mr. Chee used his February Bankruptcy Petition Hearing, for example, to circulate his court documents to the international media, and he outlined how and why he didn't believe Singapore's judicial system was independent when dealing with opposition politicians. He was also able to remind the international media of the criticisms leveled at the Singapore judicial system by Amnesty International, the International Commission of Jurists and the New York Bar Association. Mr. Chee was not intimi-

dated by the prospect, and subsequent reality, of a suit for contempt of court.

Lee Kuan Yew has since secured a summary judgment for his defamation case against Mr. Chee and his sister and SDP colleague, Chee Siok Chin, arising out of the last election campaign. However, while the Chees were thus denied their request for a public hearing, their detailed defense of what they regard as fair comment on a matter of public interest was posted on various Web sites. Moreover, they are challenging the decision to award a summary trial as unconstitutional. In effect, the Chees are taking a foundational PAP myth seriously to see where it leads.

Meanwhile, economic globalization is contributing to a growing scrutiny of, and challenge to, Singapore's governance system. Currently a request for review by the Toronto-based oil and natural gas company, EnerNorth Industries, is pending before the Canadian Supreme Court. It is seeking to overturn a decision by the Ontario Superior Court of Justice to abide by a Singapore High Court ruling. This went against EnerNorth in its dispute with Singaporean company Oakwell Engineering and it faces the prospect of having its assets seized under Canadian law to pay for that judgment. However, EnerNorth's appeal centers round the contention that: "Singapore is ruled by a small oligarchy who control all facets of the Singapore state, including the judiciary, which is utterly politicized."

There is also increasing international scrutiny of the governance rules and regulations pertaining to Singapore's domestic market. Already this includes critical attention by the International Monetary Fund and U.S. negotiators involved in the U.S.-Singapore Free Trade Agreement. Concerns have been raised about levels of transparency, possible conflicts of interest pertaining to appointments within the state and the advantages open to govern-

ment-linked companies by virtue of political networks to which they belong.

The second foundational PAP myth about the threat to political and social order posed by political pluralism has also manifested itself in a range of measures curbing political expression. The most explicit symbol of this myth is to be found in the Societies Act, which bars political activity by groups not specifically registered for this purpose. In effect, this outlaws civil society—both as an alternative to formal politics or as a complement to it.

Whereas in a liberal democracy widespread political engagement by social groups is viewed as functional for the political system, the PAP worries that this opens the door to “hidden agendas” and special interest politics. As Lee Hsien Loong stated in 2001: “It will be very tragic if Singaporeans are divided into many special interest groups and each one asserts its demands, and you’re unable to form a consensus.”

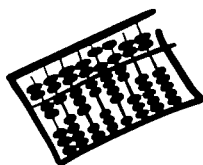
Attempts by political parties to engage with the general public, particularly by the SDP, have been frustrated by administrative and other impediments. Such were the difficulties experienced by the SDP in obtaining permits for public meetings that they have on occasions deliberately violated the Public Entertainment and Meetings Act. This resulted in prosecutions of SDP members and two prison terms in 1999 for Mr. Chee. The SDP has generally been deploying nonviolent civil disobedience to highlight administrative impediments to free speech and collective action.

One of the contemporary challenges for the PAP in the control of political expression has been the Internet. The essence of the government’s response has been to superimpose the spirit of the Societies Act on cyberspace. This includes the requirement for

registration with the Singapore Broadcasting Authority of political Web sites and the barring of nonparty political associations from political promotion, advertising or campaigning during elections. As Senior Minister of State Balaji Sadasivan explained: “In a free-for-all Internet environment, where there are no rules, political debate could easily degenerate into an unhealthy, unreliable and dangerous discourse, flush with rumors and distortions to mislead and confuse the public.”

These controls have proved remarkably effective. However, during the May election, individuals defied the government edict barring political blogging and podcasting. There were around 50 Web sites and blogs producing political or semipolitical content during the election, according to the Institute of Policy Studies in Singapore. Among other things, this provided venues for critical analysis and views to be aired by individuals and it enabled videos of sizeable opposition rallies, blanketed in the state-controlled media, to be made available. This is an important development, since it challenges the PAP preference for all forms of political expression to be channeled through state-controlled institutions and the idea that the alternative is dangerous. A more serious challenge, though, would involve the technology’s facilitation of collective political action or mobilization. The PAP’s priority will be to prevent this.

Clearly the PAP’s determination to insulate its foundational myths remains resolute and attempts to challenge these continue to attract a harsh response from Singapore’s authorities. However, because of economic globalization and the use of new technologies, that exercise is likely to require continued refinement and creative energy. ■



The Charade Of Meritocracy

by Michael D. Barr



THE LEGITIMACY OF the Singaporean government is predicated on the idea of a meritocratic technocracy. A tiny number of career civil servants play a leading role in setting policy within their ministries and other government-linked bureaucracies, leading both an elite corps of senior bureaucrats, and a much larger group of ordinary civil servants. Virtually all of the elite members of this hierarchy are “scholars,” which in Singapore parlance means they won competitive, bonded government scholarships—the established route into the country’s elite.

Scholars not only lead the Administrative Service, but also the military’s officer corps, as well as the executive ranks of statutory boards and government-linked companies (GLCs). Movement between these four groups is fluid, with even the military officers routinely doing stints in the civilian civil service. Together with their political masters, most of whom are also scholars, they make up the software for the entity commonly known as “Singapore Inc.”—a labyrinth of GLCs, statutory

boards and ministries that own or manage around 60% of Singapore’s economy.

The basis of the scholars’ mandate to govern is not merely their performance on the job, but also the integrity of the process that selected them. The educational system is designed to cultivate competition, requiring top students to prove themselves every step of the way. Singapore’s schools first stream students into elite classes after Primary 3 and 4. They then compete for entry into special secondary schools and junior colleges, before vying for government and government-linked scholarships to attend the most prestigious universities around the world.

These scholarships typically require several years of government service after graduation, and the scholars are drafted into the Administrative Service, the officer corps of the Singapore Armed Forces (SAF), or the career track of a statutory

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board or GLC. The government insists that all Singaporeans have equal opportunities to excel in the system, and that everyone who has made it to the top did so purely by academic talent and hard work. Other factors such as gender, socioeconomic background and race supposedly play no more than a marginal role, if they are acknowledged as factors at all.

On the point of race, the Singapore government has long prided itself on having instituted a system of multiracialism that fosters cultural diversity under an umbrella of national unity. This is explicitly supposed to protect the 23% of the population who belong to minority races (mainly ethnic Malays and Indians) from discrimination by the Chinese majority.

But this system conceals several unacknowledged agendas. In our forthcoming book, *Constructing Singapore: Elitism, Ethnicity and the Nation-Building Project*, Zlatko Skrbis and I present evidence that the playing field is hardly level. In fact, Singapore's system of promotion disguises and even facilitates tremendous biases against women, the poor and non-Chinese. Singapore's administrative and its political elites—especially the younger ones who have come through school in the last 20 or so years—are not the cream of Singapore's talent as they claim, but are merely a dominant social class, resting on systemic biases to perpetuate regime regeneration based on gender, class and race.

At the peak of the system is the network of prestigious government scholarships. Since independence in 1965, the technique of using government scholarships to recruit cohorts of scholars into the administrative and ruling elite has moved from the periphery of Singaporean society to center stage. Even before independence, a makeshift system of government and Colombo Plan scholarships sent a few outstanding scholars overseas before putting them into government service, including

most notably former Prime Minister Goh Chok Tong. Yet as late as 1975 this system had contributed only two out of 14 members of Singapore's cabinet. Even by 1985, only four out of 12 cabinet ministers were former government scholars.

By 1994, however, the situation had changed beyond recognition, with eight out of 14 cabinet ministers being ex-scholars, including Prime Minister Goh. By 2005 there were 12 ex-scholars in a Cabinet of 19. Of these, five had been SAF scholars, including Prime Minister Lee Hsien Loong. A perusal of the upper echelons of the ruling elite taken more broadly tells a similar story. In 1994, 12 of the 17 permanent secretaries were scholars, as were 137 of the 210 in the administrative-officer class of the Administrative Service.

The government scholarship system claims to act as a meritocratic sieve—the just reward for young adults with talent and academic dedication. If there is a racial or other bias in the outcomes, then this can only be the result of the uneven distribution of talent and academic application in the community. As Prime Minister Lee Hsien Loong put it when he spoke on national television in May 2005, “We are a multiracial society. We must have tolerance, harmony. ... And you must have meritocracy ... so everybody feels it is fair....” His father, former Prime Minister Lee Kuan Yew, was making the same point when, in 1989, he told Singapore's Malay community that they “must learn to compete with everyone else” in the education system.

Yet if Singapore's meritocracy is truly a level playing field, as the Lees assert, then the Chinese must be much smarter and harder working than the minority Indians and Malays. Consider the distribution of the top jobs in various arms of the Singapore government service in the 1990s (based on research conducted by Ross Worthington in the early 2000s):

• *Of the top 30 GLCs only two (6.7%) were chaired by non-Chinese in 1991 (and neither of the non-Chinese was a Malay).*

• *Of the 38 people who were represented on the most GLC boards in 1998, only two (5.3%) were non-Chinese (and neither of the non-Chinese was a Malay).*

• *Of the 78 "core people" on statutory boards and GLCs in 1998, seven (9%) were non-Chinese (and one of the non-Chinese was a Malay).*

A similar outcome is revealed in the pattern of government scholarships awarded after matriculation from school. Of the 200 winners of Singapore's most prestigious scholarship, the President's Scholarship, from 1966-2005 only 14 (6.4%) were not Chinese. But this was not a consistent proportion throughout the period. If we take 1980 as the divider, we find that there were 10 non-Chinese President's Scholars out of 114 from 1966-80, or 8%, but in the period from 1981-2005 this figure had dropped to four out of 106, or 3.8%. Since independence, the President's Scholarship has been awarded to only one Malay, in 1968. There has been only one non-Chinese President's Scholar in the 18 years from 1987 to 2005 (a boy called Mikail Kalimuddin) and he is actually half Chinese, studied in Chinese schools (Chinese High School and Hwa Chong Junior College), and took the Higher Chinese course as his mother tongue. If we broaden our focus to encompass broader constructions of ethnicity, we find that since independence, the President's Scholarship has been won by only two Muslims (1968 and 2005).

If we consider Singapore's second-ranked scholarship—the Ministry of Defence's Singapore Armed Forces Overseas Scholarship (SAFOS)—we find a comparable pattern. The Ministry of Defence did not respond to my request for a list of recipients of SAF scholarships, but using newspaper accounts and information provided by the Ministry of Defence Scholar-

ship Centre and Public Service Commission Scholarship Centre Web sites, I was able to identify 140 (56%) of the 250 SAFOS winners up to 2005.

Although only indicative, this table clearly suggests the Chinese dominance in SAFOS stakes: 98% of SAFOS winners in this sample were Chinese, and about 2% were non-Chinese (counting Mikail Kalimuddin in 2005 as non-Chinese). Furthermore I found not a single Malay recipient and only one Muslim winner (Mikail Kalimuddin). A similar picture emerges in the lower status Singapore Armed Forces Merit Scholarship winners: 71 (25.6%) of 277 (as of late 2005) scholars identified, with 69 (97%) Chinese winners to only two non-Chinese—though there was a Malay recipient in 2004, and one reliable scholar maintains that there have been others.

The position of the non-Chinese in the educational stakes has clearly deteriorated since the beginning of the 1980s. According to the logic of meritocracy, that means the Chinese have been getting smarter, at least compared to the non-Chinese.

Yet the selection of scholars does not depend purely on objective results like exam scores. In the internal processes of awarding scholarships after matriculation results are released, there are plenty of opportunities to exercise subtle forms of discrimination. Extracurricular activities (as recorded in one's school record), "character" and performance in an interview are also considered. This makes the selection process much more subjective than one would expect in a system that claims to be a meritocracy, and it creates ample opportunity for racial and other prejudices to operate with relative freedom.

Is there evidence that such biases operate at this level? Unsurprisingly, the answer to this question is "yes." Take for instance a 2004 promotional supplement in the country's main newspaper used to recruit applicants for scholarships. The ad-

PRESIDENT'S SCHOLARS BY RACE

	Chinese	Non-Chinese		Chinese	Non-Chinese
1966	8	1	1986	7	0
1967	6	1	1987	6	1
1968	4	2	1988	5	0
1969	4	0	1989	6	0
1970	8	0	1990	5	0
1971	8	1	1991	4	0
1972	10	1	1992	4	0
1973	10	1	1993	3	0
1974	8	0	1994	4	0
1975	7	0	1995	3	0
1976	8	1	1996	3	0
1977	5	0	1997	4	0
1978	6	1	1998	2	0
1979	7	0	1999	1	0
1980	5	1	2000	3	0
1981	8	1	2001	3	0
1982	5	1	2002	4	0
1983	4	0	2003	5	0
1984	4	0	2004	2	0
1985	5	0	2005	2	1

	Chinese	Non-Chinese
TOTAL	206	14

SOURCE: SINGAPORE'S PUBLIC SERVICE COMMISSION

vertorial articles accompanying the paid advertisements featured only one non-Chinese scholar (a Malay on a lowly "local" scholarship) amongst 28 Chinese on prestigious overseas scholarships. Even more disturbing for what they reveal about the prejudices of those offering the scholarships were the paid advertisements placed by government ministries, statutory boards and GLCs. Of the 30 scholars who were both prominent and can be racially identified by their photographs or their names without any doubt as to accuracy, every one of them was Chinese. This leaves not a shadow of a doubt that those people granting government and government-linked scholarships presume that the vast majority of high-level winners will be Chinese.

The absence of Malays from the SAFOS scholarships and their near-absence from the SAF Merit Scholarships deserves special mention because this is an extension of discrimination against the admission of Malays into senior and sensitive positions in the SAF that is officially sanctioned. The discrimination against Malays has been discussed in parliament and the media, and

is justified by the assertion that the loyalty of Malays cannot be assumed, both because they are Muslim and because they have a racial and ethnic affinity with the Malays in Malaysia and Indonesia. Current Prime Minister Lee Hsien Loong has historically been a vocal defender of this policy.

This discrimination hits Malay men hard, first because it deprives many of promising careers in the army, and second—and more pertinent for our study of the elite—it all but completely excludes potentially high-flying Malays of a chance of entering the scholar class through the SAF. A Chinese woman has a much better chance of winning an SAF scholarship than a Malay man.

Yet even before the scholarship stage, the education system has stacked the deck in favor of Chinese, starting in preschool. Here is the heart of Singapore's systemic discrimination against non-Chinese. Since the end of the 1970s, the principles of "meritocracy" and "multiracialism" have been subverted by a form of government-driven Chinese chauvinism that has marginalized the minorities. It was not known to the public at the time, but as early as 1978, then Prime Minister Lee Kuan Yew had begun referring to Singapore as a "Confucian society" in his dealings with foreign dignitaries. This proved to be the beginning of a shift from his record as a defender of a communally neutral form of multiracialism toward a policy of actively promoting a Chinese-dominated Singapore.

The early outward signs of the Sinicization program were the privileging of Chinese education, Chinese language and selectively chosen "Chinese values" in an overt and successful effort to create a Mandarin- and English-speaking elite who would dominate public life. Two of the most important planks of this campaign were decided in 1979: the annual "Speak Mandarin Campaign" and the decision to preserve and foster a collection of

elite Chinese-medium schools, known as Special Assistance Plan (SAP) schools.

The SAP schools are explicitly designed to have a Chinese ambience, right down to Chinese gardens, windows shaped like plum blossoms, Chinese orchestra and drama, and exchange programs with mainland China and Taiwan. Over the years the children in SAP schools have been given multiple advantages over those in ordinary schools, including exclusive preschool programs and special consideration for preuniversity scholarships.

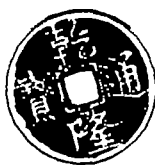
For instance, in the early 1980s, when there was a serious shortage of graduate English teachers in schools, the Ministry of Education ensured there were enough allocated to SAP schools “to help improve standards of English among the Chinese-medium students, in the hope that they will be able to make it to university”—a target brought closer by the granting of two O-level bonus points exclusively to SAP school students when they applied to enter junior college. By contrast, neither Indians nor Malays received any special help, let alone schools of their own to address their special needs. They were not only left to fend for themselves, but were sometimes subjected to wanton neglect: inadequately trained teachers, substandard facilities and resources and the “knowledge” that they are not as good as the Chinese.

This account of discrimination against non-Chinese might lead the reader to assume that the quarter of Singaporeans who are not Chinese must form a festering and perhaps even revolutionary mass of resentment. Such an assumption would, however, be a long way from the mark. Non-Chinese might be largely excluded from the highest levels of the administrative elite, but just below these rarefied heights there plenty of positions open to intelligent and hardworking non-Chinese—certainly enough to ensure that

non-Chinese communities have much to gain by enthusiastically buying into the system, even after the glass ceilings and racial barriers are taken into account. There are many grievances and resentments in these levels of society but the grievances are muted and balanced by an appreciation of the relative comforts and prosperity they enjoy. For most, any tendency to complain is subdued also by knowledge that it could be worse, and the widespread assumption among members of minority communities that it will be if they seriously pursue their grievances. As long as the Singapore system continues to deal such people a satisfactory hand, if not a fair one, it should be able to cope with some quiet rumblings in the ranks.

While this discrimination is not sparking a reaction that threatens the regime in the short term, the resulting injustices are certainly undermining the myth that the regime operates on meritocratic principles. This is worrying in the longer term because this myth, along with the capacity to deliver peace and prosperity, is one of the primary rationales by which Singaporeans reluctantly accept the many unpopular aspects of the regime, such as the lack of freedom and democracy, the intrusion of government into most aspects of private life, the pressure-cooker lifestyle and the high cost of living.

The rhetoric of meritocracy has given Singaporeans the consolation of believing that their ruling elite are the best of the best and can therefore be trusted almost blindly on important matters, even if they are highhanded and lack the common touch. As this illusion gradually falls away—and today it is already heavily undermined—the trust that Singaporeans have for their government is becoming increasingly qualified. It remains to be seen how long the regime can avert the logical consequences of the contradictions between the myth and the reality. ■



Financial Center Pipedreams

by Hugo Restall



THERE IS NO denying that for financiers, Singapore has plenty of buzz these days. When a large European bank held a reception there recently for its prime brokers to meet potential hedge fund clients, it expected a couple hundred people. Instead more than 700 showed up. The influx of fund managers and private bankers has helped create a shortage of high-end housing, and as a result prices have risen 20% to 30% in the last year. Office rents just posted a 13% quarter-on-quarter rise, the highest ever, and are expected to break through their 1996 peak within the next couple years.

So is Singapore succeeding in its ambition to become a regional financial center? In some ways, yes. It has certainly enhanced its attractiveness to certain segments of the financial sector. But at the same time it seems to be falling further behind in the race to become the pre-eminent integrated hub. The analogy some use is that Singapore is becoming the Zurich to Hong Kong's London, or the Greenwich, Connecticut to Hong Kong's Manhattan.

For high net-worth individuals, Singa-

pore's banking secrecy laws make it highly attractive as a place to stash funds out of sight of their own country's authorities—especially since some havens like Switzerland have recently watered down their guarantees of confidentiality. The super-rich of Southeast Asia have long used Singapore as a bolt-hole, both from political instability and the long arm of the law. Now new money is flowing in not only from Europe, but also from China. That's because since the 1997 handover, wealthy Chinese trust Hong Kong less as there is a perceived risk that mainland authorities will exert their authority there.

Meanwhile, Asia is in the middle of a hedge-fund boom, with assets flowing in at a rate of \$12 billion to \$15 billion per year. Singapore has offered tax breaks, simpler registration, and even mandates to manage some of its own massive pool of pension savings as enticements for fund managers to locate there. Since many of these individuals trade from wherever they happen to be and spend much time

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travelling around the region, they can essentially live wherever they want.

That means Singapore's clean environment and efficient urban planning come into play. With Hong Kong's air quality deteriorating rapidly and the government so weak it is unable to undertake the building of a cultural center in West Kowloon, it is no wonder that those who can move are doing so. Employers are beginning to rethink whether they need to pay Hong Kong's higher costs in order to be close to the market. The exodus looks much like the way U.S. hedge funds have moved out of New York City to the suburbs or other cities.

However, the appearance that everything is going Singapore's way is misleading. For one thing, the benefits of attracting fund managers are small. In this year's budget, the government announced preferential tax treatment, meaning that the local coffers will only get a small bite of this growing pie. The local market may also get a slight boost, but the biggest plus is the extra consumption and employment in the local economy. In fact, the bid is reminiscent of Singapore's past efforts to attract targeted industries like the Internet or biotech. It usually ends up paying top dollar, and then repenting at leisure as it turns out that it jumped on the bandwagon too late.

Meanwhile, Hong Kong is actually solidifying its position as the premier financial center for East Asia. Its stock market is outpacing rivals in the race to become large and liquid enough to intermediate the huge flows of capital needed to reform China's state-owned enterprises.

One proof of that should come later this month, when what could be the world's largest IPO is scheduled. Hong Kong retail investors are already lining up to buy into Industrial and Commercial Bank of China. With \$815 billion in assets, the bank is the largest on the mainland, is expected to

raise as much as \$21 billion, about \$17 billion of that in Hong Kong and the remainder in Shanghai.

A flood of IPOs—\$21.2 billion worth last year—is fueling Hong Kong's self-confidence as the pre-eminent regional financial center. No longer does the city look over its shoulder at Shanghai. Instead it is Wall Street that is starting to get twitchy about the Hong Kong market's ability to handle such massive offerings.

Meanwhile, the Singapore exchange, with a total market capitalization about one-quarter the size of Hong Kong at the end of last year, gets a few smaller Chinese companies listing, and for a while local investor interest was keen in these shares. But a derivatives trading scandal involving China Aviation Oil in late 2004 nearly blew up the company, and also raised questions about whether the Singaporean regulators were lowering their standards to attract listings. Trust in Chinese companies coming to Singapore evaporated almost overnight, and oversight had to be tightened in order to rebuild it.

Even in terms of being a center for fund management, Hong Kong is arguably maintaining or enlarging its lead over Singapore. It still attracts the larger funds, which want to be physically close to the main market so they can have plenty of contact with the managers of companies. Singapore doesn't hold much appeal because its market is dominated by stodgy government-linked companies.

The real potential for a breakthrough lies in the development of an Asian bond market. The issuance of local currency bonds has more than quadrupled in the last 10 years from a very low base. Everyone agrees that the region would benefit hugely if it could reduce companies' reliance on bank debt by making bond issues more accessible. So can Singapore take the lead?

It seems unlikely however that Singa-

pore could develop this market on its own. One hurdle is the lack of a benchmark government security issued in a convertible local currency. India and China are the two giant sovereign issuers with the potential to create a market. And both are going to want to create their own financial centers.

Last March, India announced its intention to create a road map for convertibility of the rupee. Ultimately that will boost Mumbai's ability to cut out Singapore as a gateway to India.

And there is talk of Chinese companies being allowed to issue yuan-denominated bonds in Hong Kong. It is not inconceivable for Beijing to make a pragmatic decision to promote Hong Kong as a bond trading center. Already Hong Kong banks are beginning to conduct yuan-denominated business.

The other countries in Southeast Asia are hardly likely to welcome Singaporean control over their access to capital. While relations are stable, the recent outburst of public anger in Thailand at the sale of former Prime Minister Thaksin Shinawatra's family stake in Shin Corp. to the Singaporean government holding company Temasek shows the depth of suspicion lurking beneath the surface. Effigies of Prime Minister Lee Hsien Loong and his wife Ho Ching, the head of Temasek, were burned in the streets of Bangkok. Temasek has repeatedly faced problems investing abroad because it is perceived as an agent of the government, with political as well as commercial motivations. The conflict with Malaysia over the trading of Malaysian shares in Singapore in the 1990s also shows the regional unwillingness to cede market leadership to the city state.

Singapore is thus paying a price for its government-led economic model, which is intertwined with its system of social control at home. Instead of nurturing a do-

mestic entrepreneurial class with its own vested interests, it has kept the commanding heights of the economy under the control of Singapore Inc. Therefore its financial institutions have not been welcomed abroad in the way that Switzerland's have.

Individual institutions will also have to consider the political problems of doing business in Singapore. Market players were shocked this month by the sudden resignation of Morgan Stanley Asia economist Andy Xie, reportedly after he sent an internal email disparaging Singapore's financial center ambitions: "Actually, Singapore's success came mainly from being the money laundering centre for corrupt Indonesian businessmen and government officials. Indonesia has no money. So Singapore isn't doing well. To sustain its economy, Singapore is building casinos to attract corrupt money from China." Mr. Xie could not be reached to comment on his resignation.

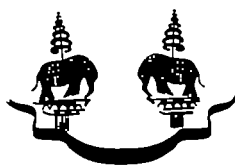
Such undiplomatic remarks from an economist would never be welcomed by an investment bank. But Mr. Xie's resignation suggests just how sensitive the political climate there is for financial institutions. For hedge funds, then, the question is to what extent they could take bets against the Singapore economy or prominent Singaporean companies without wearing out their welcome. Such concerns don't enter the picture in Hong Kong, and indeed mainland China is not so thin-skinned. Ten years after the handover, Hong Kong's freedom of information has unexpectedly proved resilient, while Singapore has failed to liberalize.

So it is difficult to see Singapore continuing to enjoy its current success. Fund managers may be happy to receive tax breaks, but their mobility and fickleness means there is not much of a network effect to keep them in Singapore for the long term. Meanwhile Indonesia is exerting

pressure to conclude an extradition treaty and amend its secrecy laws in order to stop the outflow of illicit funds.

Singapore deserves credit for financial market deregulation since 1998 and the opening of the local banking sector to foreign competition. But as long as it pursues

a strategy that alienates its neighbors, it will be unable to realize its ambition of becoming a fully fledged financial hub. Ultimately such centers depend on cooperative relationships, while at the moment Singapore is still seen as an opportunistic player. ■



Bangkok's Elitist Coup

by Michael H. Nelson



ONE DAY AFTER the military putsch in Thailand had initiated the end of the so-called "Thaksin system," an academic friend with a strong interest in Thai politics sent me an email saying that he was shocked. There must be many other, superior ways to deal with the political crisis than resorting to military intervention, he said. His sentiments were echoed by many foreign governments—including the United States, which slammed Thailand for its "U-turn" on democracy.

Seen from the perspective of democracy, the people of Bangkok surely should have taken to the streets in masses to prevent their "people's constitution" from being run over by the tracks of army tanks. Unlike the mass protests against Prime Minister Gen. Suchinda Kraprayoon in May 1992, the people did not mobilize resistance and gather on Bangkok's Rajdamnoen Avenue and around the Democracy Monument. Instead, on the night of the coup, traffic on mobile phone networks and the Internet increased to such an extent that these services almost broke down. People

seemed to be in a state of excited curiosity: Who were the coup plotters? Would Mr. Thaksin win or would the military?

The day after, when it was clear that Army Commander-in-Chief Gen. Sonthi Boonyaratkalin and his group had prevailed, people came out in the thousands to have a look themselves. And they started presenting the soldiers with water, food and flowers. It was especially popular to take pictures with the soldiers, preferably posing together with them in front of their tanks. Was this the appropriate way of treating military personnel who had just abrogated democracy, the citizens' greatest political treasure? Foreigners became even more puzzled. Their confusion further increased when the anti-Thaksin (although not necessarily pro-democracy) People's Alliance for Democracy (PAD) ceased their activities, arguing that the coup had achieved what they had fought

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for. As far as protest initiator Sonthi Limthongkul is concerned, this is probably accurate. After all, he has never been able to demonstrate that his actions had been motivated by anything more principled than an egotistical, personal vendetta against Mr. Thaksin after Mr. Sonthi lost his television show.

As reported in the Bangkok Post on Sept. 22, Chamlong Srimuang, one of the five core members of the PAD, who also helped bring down Gen. Suchinda in 1992, said: "Not once in Thai history have Thais been so divided. Nothing but a coup could have remedied such a situation." He thus adopted some of the same reasons for the coup given by its plotters. And when the king took the step of officially endorsing the coup group's action, the first sentence of his order said, as reported by The Nation on Sept. 22, "Gen. Sonthi informed His Majesty the King that Thaksin Shinawatra as the prime minister [caused] severe division within the nation and destroyed national unity. This is something that has never happened in the country's history."

The dichotomy of "national unity" and "division" has long been part of the national elites' hegemonic ideology. Since the king is the core symbol of the elite, it was significant that the coup group, in its first announcement, included accusations of actions close to *lèse majesté* against the "revered king" allegedly committed by the Thaksin administration as one of the reasons for their takeover. From this perspective, democracy is fine, but national unity under the unchallenged leadership of the king comes first.

It is important to recall that in mid-July the former army chief and prime minister, Privy Council President Gen. Prem Tinsulanonda, in full military uniform and in the presence of Gen. Sonthi, had delivered a speech to 950 cadets from Chulachomklao Royal Military Academy

reminding them that soldiers served His Majesty the King and the country, not any particular government.

GENUINE DEMOCRATS WERE in a dilemma about the meaning of the coup. Thongbai Thongpao, a former senator in the anti-Thaksin camp and political prisoner under an earlier military junta, admitted that the putsch had relieved him of a great burden. Thailand's political problems, all presumably caused by Mr. Thaksin, he wrote in the Bangkok Post on Sept. 24, "could not be solved through peaceful means or by law. We had exhausted all possible means to resolve the deadlock... Although it is a strong medicine, a poison even, a coup might sometimes be a much-needed solution."

This view does not see the coup as anti-democratic. Rather, the military had salvaged democracy from the clutches of a moneyed political predator. This pro-coup position is decidedly against any signs of military rule, and advocates returning power to the people as soon as possible.

The widespread ambivalence in evaluating the coup was aptly expressed by a taxi driver from Sa Kaew province who recently drove me to Chatuchak skytrain station. Asked whether he found the putsch good or bad, he spontaneously answered "Bad!" But the reasons he gave could equally have been used in support of the coup: there had been political turmoil, street protests and the closure of roads around Government House. After a brief pause, he added, "Well, the coup is also bad because it is not democratic." This taxi driver did not mention Mr. Thaksin, who is normally the sole reason why more ideologically inclined journalists, academics and other members of Bangkok's middle class temporarily overcome their abhorrence of coups.

Two days after the event, the Thai-language daily Matichon headlined its edito-

rial, "Why did there have to be a 'coup'?" The final answer was to be found in the concrete results that a serious push of the junta for establishing legal proof of Thaksin's abuse of power might yield. As with the coup against Gen. Chatichai Choonhavan in 1991, the coup provided a unique opportunity to show the truth of many of the accusations concerning abuse of power and corruption that have been brought against Mr. Thaksin, his family and cabinet members. It would be morally and politically fatal not only for the military, but equally for the anti-Thaksin activists, if only minor crimes were brought to light.

The coming investigations are supposed to confirm three core assumptions that, according to an article that Jon Ungphakorn, a previous senator in the NGO camp, placed on his news web site Prachatai (Sept. 22), can justify the coup in the eyes of many principally democracy-minded "people's sector" activists. First, the Thaksin government had inflicted a great deal of harm on society and democracy. In fact, this assumption fits well with the dehumanization of and hate campaign against Mr. Thaksin during the prolonged street protests organized by the PAD. Second, there was no prospect of solving the crisis caused by the Thaksin government by using democratic means—before the harm would have turned into disaster. This aspect plays on the themes of "violence" and even "civil war" that were—sincerely or pragmatically—introduced as reinforcements into the anti-Thaksin discourse. It also avoids considering whether the PAD's tactics had substantially contributed to creating the crisis the coup was supposed to solve. Third, compared to the continuation of Mr. Thaksin in power, a short-term military coup in order to recover the structure of democracy was the "lesser evil." In sum, Mr. Thaksin got what he deserved, and it is good that he is gone—by whatever means.

But was Mr. Thaksin really as bad as to



A monk walks past the reflection of a tank outside a Buddhist temple in Bangkok.

make a coup appear justified? In his article "Bad excuses for the coup," Thongchai Winichakul, a veteran of the student movement in the 1970s and now a professor of history at the University of Wisconsin, poses this challenge: "Thaksin opponents, including many academics, lost their sense of perspective and their good judgment because they were consumed by hatred." Professor Thongchai ends his attack with an unequivocal "There is NO excuse for the coup."

Some concern has been voiced over what the coup might mean for the democratization of Thailand's political culture. In an op-ed piece in the Bangkok Post, Chaiwat Satha-Anand, peace advocate and professor of political science at Thammasat University, rejected the coup on moral grounds "because of what it has done to the society that accepts it as right." In a similar vein, Pasuk Phongpaichit (co-author with Chris Baker of *Thaksin: The Business of Politics in Thailand*), bemoaned in Matichon that the military takeover has reinforced the belief that political problems could be solved by the use of weapons and force. I do think that the events have re-actualized the possibility of a coup that is embedded in Thailand's political culture. But this is only one element. The other is the discursively determined restrictive conditions under which a coup might be permitted. These condi-

tions, just like with the putsch in 1991 and the mass demonstrations that pushed previous coup-leader Gen. Suchinda from office in the “Bloody May” of 1992, have also been re-actualized and thereby stabilized the rejection of coups as a normal means of power transfer. Moreover, the reactions to the coup have reconfirmed that any military rule will be strictly rejected, while they reinforced the ideal of democracy, and put additional pressure on the politicians to shape up their act. Combined with a historical perspective on the development of the role of the military, coups and democracy in Thailand, this view should provide hope for the strengthening of a democratic political culture.

When the Bangkok elite urge for the “return of power to the people as soon as possible” it is not really meant to include Thailand’s rural population. After all, they had been responsible for putting Thaksin in power, and made him unassailable in the 2005 election. Should the electoral mandate be returned to the rural majority of voters before mechanisms are put in place that prevent them from voting for the “wrong” candidates again? A comment on an article on the Prachatai Web site puts it this way: “I hope everyone’s brave enough to admit that the elite’s principle of democracy is more effective than [the] ‘rationality’ of rural majority.”

To the rural majority that had overwhelmingly voted for Mr. Thaksin in the 2005 election, the meaning of the coup might differ substantially from what Bangkokians think. But the rural majority has no voice in the public sphere, which is mo-

nopolized by people belonging to the urban educated middle class. On the day after the coup, I joined the cook of our apartment building in watching a coup announcement on the television in her kitchen. Unprompted and very sincerely, she praised Mr. Thaksin for the many good things that he had done for the small people, the *ban nok* (countryside) people. She mentioned the 30-baht health scheme, the village fund and debt suspension. She even attributed running water, asphalted roads, and electricity to the former prime minister. To her, it seemed, a hero had been taken away. Her implicit concern was that the life of people such as hers would suffer as a result of the coup and of new people coming to power, who might not care for the majority of *ban nok* Thais.

Similarly, the Associated Press quoted a soldier “from the rural heartland” who had voted for Mr. Thaksin, and was guarding a checkpoint with tanks near the old Bangkok airport at Don Muang, saying that he felt conflicted. “I’m a soldier, but I am sad,” he said, referring to the current situation. “Our leader was really good. In order to become our leader, he had to be the best.”

Open contempt for rural voters had already been a constituent component of the PAD’s street protests against Mr. Thaksin earlier in 2006. Whatever else the coup might have done to Thailand’s political culture, it has also confirmed the voiceless and subordinate role of the rural majority in national politics. From this perspective, the coup has reinforced the duality of democracy in Thailand. ■



Putting Thailand Together Again

by Colum Murphy



EDITOR'S NOTE: Less than 12 hours before Thailand's military coup of Sept. 19, REVIEW Deputy Editor Colum Murphy met with the king's closest advisor, Gen. Prem Tinsulanonda, president of the Privy Council. One day later, Mr. Murphy spoke with Anand Panyarachun, who was appointed interim prime minister the last time the military seized power in Thailand in 1991. Full transcripts of both interviews can be read at www.feer.com.

SPEAKING SLOWLY AND softly in Thai-accented English, Gen. Prem Tinsulanonda cordially invited me to take a seat alongside him on a three-seater beige leather sofa inside the Privy Council. Yet there was a steely edge to him that suggested this is not a man who should be crossed—as Paul Handley, author of the controversial biography *The King Never Smiles* (Yale University Press, 2006), seems to have done. The general was not shy about sharing his contempt for Mr. Handley's book—banned in Thailand—which asserts that King Bhumibol Adulyadej's interference in domestic

politics has retarded the development of Thai democracy. "I don't like it. The nation doesn't like it," he told me later in the interview. "It's a hearsay book and is not based on the fact. We are worried [about] the foreigners who read it. My suggestion is—please ignore that book. It's useless."

Again, at the conclusion of our interview, Gen. Prem gave me another glimpse of his authoritarian side when he politely, but firmly, insisted that he get to review the quotes in this article before publication. Although phrased as a request, I was left without doubt that failure to comply would

~ Mr. Murphy is deputy editor of the REVIEW.

have undefined but serious consequences.

The general's tough-guy streak should not have come as much of a surprise. A former commander-in-chief of the Royal Thai Army and prime minister from 1980-88, he admitted that he is first and foremost a soldier, and always will be. "An old soldier never dies," he said, quoting Gen. Douglas MacArthur, but conveniently omitted the ending, "they just fade away." The general, it seems, is not yet ready to fade away, and given the coup that was to transpire later that same evening, his role as intermediary between the palace and the barracks has become even more important.

Nevertheless, at 86 years old the signs of age occasionally show. In the course of our conversation, the general stopped to tell me about 1969, a pivotal year in his military career. He took a scrap of paper on which to do the conversion from the *suriyakati*, or Thai solar calendar, to the Western one. (Normally, the equivalent year in the Western counting system can be arrived at by subtracting the number 543 from the Thai calendar.) To be fair, it is a calculation that would be taxing to most people, but Gen. Prem took two or three minutes mulling the problem, only to get the answer incorrect. An aide came to his assistance, and the general graciously conceded: "You were right. I was wrong."

For Gen. Prem, being a soldier remains the highest calling. "Being a soldier allows you to directly serve your country," he said. It is clear that in his eyes, the military can and should play a much greater role than just defending the country from ex-

ternal threats. As evidenced by his career, the army has played a key role in tackling domestic political threats. The general told me how, more than three decades ago when parts of Thailand were plagued by communist insurgency, he devised a political strategy to defuse the conflict through dialogue.

"After three years we stopped fighting—stopped using guns and bullets and started to talk, and then we bring back peace to that part of the country," he said.

This approach was later successfully applied in other troubled parts of the country. Gen. Prem said that it is the achievements of this period—and not those during his time as prime minister—that stand out as the most memorable of his career.

Gen. Prem fell silent when it came to discussing the more recent political turmoil in Thailand, including the annulment of the April 2 elections. The subsequent political wrangling over the summer with then Prime Minister Thaksin Shinawatra eventually culminated in the Sept. 19 coup d'état. The law, he said, prevented him from publicly speaking on such topics.

Issues concerning the military, it seems, are entirely a different matter. On several occasions over the summer, most notably when he addressed the graduating cadets at the Chulachomklao Royal Military Academy in July, the general explicitly reminded the army that their allegiance belongs to the king of Thailand and not to



the government of the day. The general repeated these sentiments, telling me:

"In horse racing they have the stable and the owner of the stable owns the horse. The jockey comes and rides the horse during the race, but the jockey does not own the horse." This not-so-subtle analogy was widely interpreted to be a clear message to Mr. Thaksin: The army belongs to the king, not to the prime minister and government of the day, and any jockey that is arrogant enough to think he can ride off with the horse can expect his comeuppance.

Mr. Thaksin foolishly reacted to Gen. Prem's admonitions by protesting that his government was coming under attack by "a charismatic, extraconstitutional figure" bent on thwarting Thai democracy. The then caretaker prime minister would not identify by name the perpetrator of these antidemocratic activities, but most analysts agree that he was referring to the general—and by extension, to the royal palace. In hindsight it's clear that these innuendo-filled allegations, which arguably could classify as an offense under Thailand's strict *lèse majesté* laws, signaled the beginning of the end for Mr. Thaksin.

In many Western democracies at least, such a blatant warning to a democratically elected prime minister would indeed be seen as interference in the democratic process and, no doubt, cause uproar. But as Gen. Prem sees it, Western observers should not be too surprised if Bangkok adopts its own, Thai-style interpretation of democracy. "We are a kingdom. You are not," he said, lumping Western democracies together. "My country is about 800 years old, and we run the country as a kingdom. We will never be a republic or be without the king."

The king is the only thing that brings the people of Thailand together, he said. It seems that in Gen. Prem's eyes, unity and the maintenance of the monarchy are the most important factor in determining the

future of Thailand. "So as long as we have the king, the monarchy—this very, very good king we have right now—we will go ahead, either slowly or rapidly, but we will be united." Given this, the general said, Thailand has little reason to worry about how it would overcome the political impasse caused by the infighting between Mr. Thaksin, his Thai Rak Thai party, the members of the People's Alliance for Democracy and the main opposition parties.

I was struck by Gen. Prem's upbeat view of the Thai situation on that morning of Sept. 19. But I put most of it down to the general giving a positive "spin" on what at that point was much more than the minor blip that Gen. Prem wanted the Western press to believe. But, of course, there might be another explanation for the general's confidence. That evening at around 11 p.m. came the official announcement of the coup. The horses, it seemed, had bolted.

IF ANYONE UNDERSTANDS the challenges that will face Gen. Surayud Chulanont, the military-appointed interim prime minister, it is Anand Panyarachun. The 74-year old was selected to serve as interim prime minister following the February 1991 coup, led by General Suchinda Kraprayoon that ousted then Prime Minister Chatichai Choonhavan. One year later, when democratic elections failed to resolve the political turmoil, Mr. Anand was called upon yet again to serve as prime minister, this time only for three months. His relatively short stints in office, followed by his heavy involvement with the writing of the 1997 Constitution (abolished by the junta following last month's coup), won him the admiration of many Thais. One report even dubbed him "the savior of Thailand's democracy."

It came as a pleasant surprise then that Mr. Anand kept our interview appointment, given that the Royal Thai Army had just seized power the night before. I was

sure that Mr. Anand would be too busy keeping abreast of coup developments to meet with a Hong Kong-based journalist. But at 3 p.m. sharp, he greeted me warmly in his expansive office at the Sukhumvit Road headquarters of the Thai conglomerate Saha-Union, from which he has now retired. "They still let me use it," he explained as he gestured for me to sit down.

Born into a distinguished family that traces its roots to the Mon people of Burma, Mr. Anand spent 23 years of his career in Thailand's diplomatic corps, serving as the country's permanent representative to the United Nations as well as ambassador to the U.S. and Canada. He came across as a pragmatic businessman rather than a smooth-talking politician. The first five minutes were spent setting the ground rules for our interview. "Will you quote me verbatim?" he quizzed me. "Otherwise it is a waste of my time," he said firmly as he flashes me a wide smile.

Mr. Anand is certainly capable of turning on the charm whenever he wants. In perfect British-accented English, the former businessman-turned-diplomat and prime minister laughed as he told me how he first heard about the Sept. 19 coup. He was having dinner with friends, he explained, when his daughter, who lives in Milan, called his cellphone. "Daddy, there's a coup in Bangkok!" she exclaimed. Apparently, his daughter had heard chatter about the coup by telephone from her husband's family in Bangkok.

While news of the coup may have come as a surprise to Mr. Anand, on further reflection he conceded that a military coup was probably inevitable. "Those who have monitored the political events in Thailand in the past year should realize the seriousness of the problem and the intensity of the feelings on both sides," he said. "...from the beginning there have been attempts to deal with these problems in a legitimate and constitutional manner, but every time the

issues were raised or were brought to the constitutional machineries—the Constitution Court, election commissioners, ordinary courts of law, and even through the media—the prime minister was perceived to be blocking all avenues to resolve these problems in a legal and legitimate matter."

Although against the coup in principle, Mr. Anand said that there was a "real and imminent danger" that a physical confrontation would erupt between the pro- and anti-Thaksin camps. As such, the coup was necessary to prevent bloodshed. It is an argument that has since been echoed by many Thais, including pro-democracy academics, to justify the coup. In a way, he said, the coup was "a democratic setback." "But in another way—as in many countries like Taiwan, Hungary and several other places—when people felt that there was no democratic way of changing the government—what happened last night was, in the views of many, a last resort."

Mr. Anand was hopeful that there would be a new civilian government, fully engaged in reform—including the revision of the Constitution. And even though the coup was regrettable in many respects, things could have been worse. "I think one must take note of the fact that in spite of all the activities last night, everything was very peaceful. There were no killings, there were no deaths," he said.

When I mentioned that previous military leaders also had seized power proclaiming such lofty goals as bringing greater democracy, transparency and accountability to Thailand—only to fail. Mr. Anand warned against making comparisons between previous coups and this putsch. The Thailand of 2006 is very different from that of the past, he said.

"You have to remember that since 1992, we have had four general elections—we had peaceful transfers of power; we had governments which served full four-year terms," he said. "The armed forces, par-

The coup, said Mr. Anand, must be considered “an extremely unfortunate dead-end street.”

ticularly the army, had gone back to the barracks and had become real professional soldiers. So to me what happened must be considered to be an extremely unfortunate dead-end street.”

Besides, the political situation in Thailand in the run up to this coup was much worse than in the periods immediately preceding the previous coup. Thailand, he said, was practically “ungovernable.”

Making Thailand governable again will be the key task of the interim prime minister. Based on Mr. Anand’s experience as interim prime minister there is some hope that restoring democracy can be achieved without too much of a power struggle between the interim government and the junta. He explained that while there were some flash points between him and the army chiefs, and that he was forced to yield to their will occasionally, it was only on small points. “On major points I resisted and I had my way,” he says. Eventually he and his government managed to organize peaceful elections, and succeeded in getting the generals to go back to their barracks.

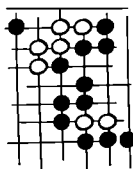
Whether Gen. Sorayud will be as effective in resisting “guidance” from the military leaders remains to be seen. Mr. Anand believes that the challenges facing a new interim prime minister are even greater than the ones he faced. Back then, he said, the unrest in Thailand was caused mainly by external factors, including an energy crisis and global political uncertainty arising from the Gulf War. Now the challenges are very much domestic in nature. In addition to maintaining peace and order—in both political and economic arenas—the problems in Thailand’s restive south will

also have to be addressed

The ongoing conflict in the southern provinces is an issue very close to Mr. Anand’s heart. He served as chairman on the National Reconciliation Commission, the government-established body set up in March 2005 and charged with finding solutions to the conflict in the south. “I hope that the change in government and perhaps the improvements in certain areas of the administration—in the judicial process, in governance—would sort of help to redeem the degree of distrust, and the degree of disrespect for the authorities [that exists in the south],” he told me.

Mr. Anand’s optimism does not stop there. One day after the coup, he seemed upbeat about Thailand’s future. “If you ask the purists and the theorists, they will say this is a setback of democracy, but I think you make two forward steps, and retreat one step, and then you catch up with the step that you lose, and then the future steps will become even faster,” he said.

Echoing sentiments expressed by Gen. Prem the day before, Mr. Anand said it all boils down to what is understood as “democracy.” “It’s not that every country has to emulate American democracy or Western-style democracy or presidential democracy. I’m sure that many countries in Europe would be appalled if they were to have an American model of democracy imposed on them. It has to be homegrown. So you respect the democratic values, you respect and practice democratic principles, but you don’t put too much emphasis just on elections or elected bodies or the executive or judiciary.” Sentiments with which Thailand’s military junta leaders would most certainly concur. ■



How Long Before the Thai Junta Splinters?

by Ukrist Pathmanand



THAILAND'S BLOODLESS COUP d'état of Sept. 19, 2006 instantly and fundamentally transformed the country's political power structure. The controversial former Prime Minister Thaksin Shinawatra was forcibly removed from his seat of power, which rested on a murky nexus of power, money and populism. In Mr. Thaksin's place was installed a group of military officers led by Army Commander-in-Chief Gen. Sonthi Boonyaratkalin.

But it would be folly to think that political power in Thailand has smoothly and simply shifted from a civilian government to a military one. It hasn't. Instead, we need to look beyond the seemingly united face of the junta to uncover where the new nexus of power actually lies. More importantly, we need to ask: Is the new power broker (or brokers) capable of bringing continued economic growth and development to an increasingly globalized Thailand? Alas, history clearly shows us that Thai military juntas have consistently been hopelessly devoid of the vision needed to lead the nation.

To understand better the dynamics of the Thai military today and consider its prospects for the future, it is helpful perhaps to first look at the recent history of the army. The period 2001-06 was a glorious time for Class 10 of the elite Armed Forces Academies Preparatory School. This graduating class of officers included among its ranks, of course, none other than Mr. Thaksin. In a society where personal relationships are especially valued, it was not particularly surprising then that many of the former prime minister's classmates progressed rapidly in their army careers while Mr. Thaksin was in office. In fact, as many as 35 out of a class of 100 men were promoted in rapid succession. It was these men who took over key positions in the army, air force and navy as well as in the Office of the Supreme Commander and even the Office of the Permanent Secretary of Defence.

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Prior to the September coup, officers from Class 10 with significant command and who were openly supportive of Mr. Thaksin included: Gen. Pornchai Kranlert, assistant army chief; Lt. Gen. Jirasit Kesakomol, commander of the First Army Corps; Maj. Gen. Prin Suwannadhat, commander of the First Infantry Division; Maj. Gen. Sanit Prommat, commander of the Cavalry Division; Maj. Gen. Ruangsak Thongdee, chief of the Anti-Aircraft Division; and Maj. Gen. Manas Paorik, deputy chief of the Third Army Corps.

However, the coup made use of only two divisions of the Thai army: one being Gen. Sonthi's own forces from the Special Forces Unit in Lopburi province in central Thailand; the other was made up of soldiers belonging to Lt. Gen. Anupong Paochinda, First Army Region commander. Lt. Gen. Anupong was an exception in that he was one of the few members of Class 10 who announced that his allegiance was, first and foremost, to King Bhumibol Adulyadej and the Thai nation. This declaration clearly alienated him from Mr. Thaksin's circle and, in 2005, the then prime minister tried to remove him from power. However, Gen. Prem Tinsulanonda, president of the influential Privy Council, stepped in to prevent Gen. Anupong's removal.

Once it became clear that the coup had been successful and that Mr. Thaksin had been completely stripped of all his military power, the two groups that formed the core of the military coup then were joined by the forces of Lt. Gen. Saprang Kalayanamitr, Third Army Region commander. As was the case with Gen. Anupong, Gen. Prem is thought to have intervened to help Lt. Gen. Saprang secure the position of Third Army Region commander. This happened during a military reshuffle which took place in 2005. Some analysts consider this reshuffle a turning point in the strategic military preparations aimed at overthrowing the Thaksin government.

Following the coup, Gen. Sonthi lost no time in dismantling the precoup structures of the military and the police force. One of his first tasks was to revamp the list of military personnel that had once been under Mr. Thaksin's control. According to reports in *The Nation*, prior to carrying out the shake up, Gen. Sonthi consulted with Gen. Prem. The outcome was the sidelining of Class 10 allies of Mr. Thaksin to inactive posts. The official announcement came on Sept. 30, and mandated that all key officers from Pre-Cadet Class 10 should take on ceremonial assignments instead of command positions. Among them is Maj. Gen. Prin Suwannadhat, who will relinquish his command of the First Infantry Division to work as an expert at the Ministry of Defence.

In contrast, most anti-Thaksin military leaders, including Lt. Gen. Anupong Paochinda and Lt. Gen. Saphrang Kalayanamit, have been rewarded with plum appointments. Both men now serve as assistants to Gen. Sonthi. In essence, all military power is now in the hands of Gen. Sonthi and his friends from Class 6 of the Armed Forces Academies Preparatory School.

THE NEW NEXUS of power faces several serious challenges, however. First, the forces under Gen. Sonthi's control are not as unified as one might think. Clearly, the main source of power will remain in the hands of Gen. Sonthi himself, and his close allies in the army, navy and police forces. These include Police Commissioner Gen. Kovit Wattana; Gen. Winai Phattiyakul, secretary-general of the junta, (which recently renamed itself the Council of National Security); and Navy Chief Adm. Sathiraphan Keyanont, all of whom belong to Class 6. But let's not forget that some army figures only chimed in with their support rather late in the game. Gen. Ruangroj Mahasaranond, the then supreme commander of the army, for example, re-



Army Chief Gen. Sonthi Boonyaratkalin stands in front of other coup leaders during a royal ceremony to endorse him as junta leader.

mained strongly pro-Thaksin right up until the day of coup. It was only later that he switched loyalties. The general—who was up for retirement anyway—resigned from the army as planned on Sept. 30.

Second, seizing power is far easier than administering a country. The political ideology of the members of the junta remains unclear, and their loyalties are very much personality-based. Ostensibly, they profess undying loyalty to the monarchy, which is understandable since this provides their justification for staging a coup. The reality, however, may be less straightforward.

Third, some of the coup's key supporters are quite old. One of the military's moral pillars is Gen. Prem. At 86 years of age, however, it will be difficult for him to sustain the energy levels that surely will be required of him to keep the junta and the various divisions of Thai army unified. Should, for whatever reason, Gen. Prem be no longer able to perform this guiding role, and Gen. Sonthi retires next year as planned, then a new power struggle within the military cannot be ruled out.

Fourth, there is always the risk that members of the current military junta may one day find themselves seduced by power and addicted to the economic benefits that come with it. Should that happen, expect to see conflicts within the military junta, possibly leading to a countercoup. Import-

tantly, this countercoup might not necessarily be initiated by pro-Thaksin soldiers, as is currently feared.

For the time being, Gen. Sonthi enjoys a good reputation as a professional soldier who does not harbor any untoward social or political aspirations. In this sense he is very different from the generals who staged the coup against the government of Gen. Chatichai Choonhavan in 1991: It wasn't long before they became power-hungry and corrupt. But when this junta's honeymoon period ends, then Thailand will need to face some difficult questions—the answers to which will have far-reaching implications for the future of the country. Specifically, will the right person be chosen to run the country?

The new interim prime minister, Gen. Surayud Chulanont, is a former military man. It is not clear yet whether he has the vision and the skills needed to lead a Thailand that has become increasingly integrated into the global economy. Already, for example, Gen. Surayud is on record as saying he will focus on improving the self-sufficiency of Thailand rather than focusing on the GDP figures.

Looking at past coups, Thailand's military leaders typically lacked vision and were unsuccessful in managing the country. The challenges facing Thailand today are even greater and go beyond the narrow, security-driven worldview that is typically found among army generals. To avoid creating more problems than they solve, the junta needs to return democracy to the people as soon as possible. The generals need to realize that even though there might be disagreements between political parties and civil society groups, ultimately this type of debate is healthy, even necessary, for a democracy to thrive. Military intervention is not the solution. Civilian politicians must be allowed to run the country again, before the military runs the country into the ground. ■



Profits Drive China's Boom

by Bert Hofman and Louis Kuijs



LIVELY DEBATE HAS emerged on how high enterprise profits are in China and what role they play in financing enterprise investment. This issue is highly relevant for policy makers for both macroeconomic and microeconomic reasons. From a macro perspective, if it is enterprise saving that drives investment rather than bank financing, monetary policy may be less effective in slowing China's rapid investment growth and other measures may need to complement the current monetary tightening in the economy. From a micro perspective, a high share of profits in investment financing may lead to inefficiencies if corporate governance is weak and much of investment is done without outside scrutiny from either owners or banks.

In several publications, the World Bank has investigated this issue. We concluded that much of China's high economy-wide saving is due to unusually high enterprise savings and, to a lesser extent, government saving. We also concluded that the impressive increase in saving in the last decade was largely due to rising enterprise profits.

And we concluded that enterprise savings now finance the majority of China's enterprise investment.

We also observed that state-owned enterprises (SOEs) are now more profitable than before, and have argued that it would be desirable if they paid more dividend to their owners, the Chinese people, through the state. SOE dividends would reduce internal financing of SOE investment and therefore lower overinvestment in China's economy. It would also increase the quality of SOE investments because banks or shareholders would more closely vet those investments.

Our conclusions surprised many and have been intensely debated, even attacked, in the press, including the *REVIEW*. In part, this debate emerged because our conclusions challenged the conventional wisdom that it is bank credit that finances the bulk of investment. We believe that misunderstanding of economic concepts

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also underlies some of the debate, as well as misunderstanding of what we have and have not said. A good example of that is Mr. Weijian Shan's essay "The World Bank's China Delusions" in the September issue of the *REVIEW*, and the shorter version of the same article in *The Wall Street Journal Asia*. These and similar reactions suggest that there is confusion over: first, the concept of enterprise savings, changes in deposits and financing surpluses or deficits; second, the relationship between profitability and the rate of return on capital; third, the possible coexistence of high profits and high stock of bad loans; and fourth, the efficiency implications of internally-financed investment. Below we elaborate on each of these points.

Behind China's Saving Rate

IT IS WELL known that China's high growth has been driven to a considerable extent by high and rising investment, which now accounts for more than 40% of GDP. How investment has been financed, or the composition of economy-wide saving, is less well-known. The conventional wisdom has long been that China's enterprise investment was financed largely by bank credit, with banks channeling the savings of China's exceptionally frugal households to unprofitable firms. To some extent this was true a decade to 15 years ago, although even then the picture was more nuanced than this. Regardless, since then things have changed: Firms have become more profitable and more of their investment is financed by enterprise saving (retained earnings plus depreciation).

What makes China stand out, compared to other countries, is high saving by enterprises and, to a lesser extent, the government. As shown by the national accounts, enterprise saving in China is now over 20% of GDP (after tax), higher than household saving, and significantly higher

than in most other countries. Moreover, only about one-third of enterprise investment is now financed externally, largely by banks, while more than half is financed by enterprise saving. Using 2005 as an example, China's investment reached over 40% of GDP in 2005, of which around 31% of GDP was done by enterprises, 6% of GDP by households and 3% of GDP by the government. Of the enterprise investment, about 10% of GDP (one-third of total enterprise investment) was financed externally, the majority by banks.

There are three reasons why enterprise saving is relatively high in China. First, industry makes up a larger share of GDP in China than in most other countries. Industry is more capital-intensive than other sectors, which means that a relatively large share of total income goes to capital in the form of interest and profits, instead of wages to labor. That is why there is, across countries, a very strong correlation between the importance of industry and the level of saving.

Our own econometric estimations suggest that China's high industry-to-GDP ratio, compared to India, can explain about nine percentage points of GDP of the gap in saving between these two countries. Second, China has a tradition of low dividend payments. This is true especially for SOEs, which still make up a significant share of the economy, especially in capital-intensive sectors like heavy industry. In the case of SOEs, the state, the largest shareholder, traditionally receives no dividend at all. Third, since the mid-1990s, profitability has increased due to rapid industrial growth and restructuring of SOEs.

Chinese households are still fairly frugal, saving over 25% of their income in recent years, or around 16% of GDP, which is more than in OECD countries, but less than in India, for instance. Household savings are high in part because they need to shoulder expenditures that are paid by the gov-

ernment or covered by insurance in other countries, such as health and education. However, household saving is only about 35% of the economy-wide total. Moreover, households use almost half of their saving to finance their own investment, largely on housing. Thus, households' financial surplus is simply not large enough to explain the difference in economy-wide saving between China and other countries, or the large increase in economy-wide saving that we have observed in the last decade.

Saving and Financing Balance

THERE IS NO contradiction between high enterprise saving and continued bank credit, or enterprise deposits in the bank, as Mr. Shan seems to imply. Savings have little to do with deposits in the bank or the buildup thereof: Enterprises can have high savings and still require bank credit simply because they invest even more than they save. The balance of savings and investment is the financial flow to enterprises. In most countries, like in China, this flow is negative for enterprises, and positive for households. So on net, households still finance part of enterprise investments in those countries.

The table with bank statistics in Mr. Shan's article in the September REVIEW nicely illustrates our point about the relative importance of bank financing in financing investment in China. Net bank financing to enterprises equals the change in the stock of loans to enterprises net of the change in the stock of enterprise deposits. Assuming that the net change in loans to households was small compared to that to enterprises, this net flow was 618 billion yuan (\$78 billion) in 2004 and 586 billion yuan in 2005. These are significant amounts, but they account for only one-fifth to one-sixth of enterprise investment, which was about 3 trillion yuan (\$379 billion) in 2004 and more than 3.7 trillion yuan in 2005.

PROFITS IN CHINA'S INDUSTRY

Enterprise profits represent an increasing share of a rapidly growing economic pie.

Unit: %	2001	2002	2003	2004	2005
Gross margin*	18.0	17.9	17.3	16.4	15.2
Total margin**	4.5	4.9	5.7	6.0	5.7
Sales revenue (growth)	11.4	16.7	28.3	31.4	27.0
Profit (growth)	8.1	20.6	42.7	38.1	22.6

* (SALES REVENUE - "COST OF SALES")/SALES REVENUE

** (SALES REVENUE - TOTAL COST)/SALES REVENUE

SOURCE: NATIONAL BUREAU OF STATISTICS

Of course, this does not mean banks no longer matter in China. First, as noted above, there still is net lending from banks. Second, gross lending to enterprises is larger than net lending—so the intermediation through banks from enterprises and households with financial surpluses to those with deficits is still substantial. This also means that the high level of enterprise savings should not make bank supervisors complacent. Moreover, the outstanding stock of loans is very large in China (140% of GDP) and this could still turn bad.

Mr. Shan sees a contradiction between our findings on enterprise savings and the accumulation of nonperforming loans by banks in recent decades. We do not see this contradiction. Indeed, particularly in the 1990s a lot of bad debt was created. Nevertheless, if the conventional wisdom about the dominance of bank lending in financing investment were true, the stock of bank lending and NPLs should have been much higher than they actually are, given that China has invested about 35% to 40% of GDP every year for a long time.

Of course, more recent lending—particularly that done during the lending boom in 2003—may still turn bad if the economy slows down. But at present the data as reported by the China Banking Regulatory Commission and those published in the audited statements of China's banks listed abroad suggest a downward trend.

Mr. Shan finds that the “gross profit margin has been declining steadily between 2000 and 2005,” as a result of which “Chinese firms are struggling.” This is in apparent contrast with our findings on rising enterprise profits. However, Mr. Shan’s conclusion is based on the “gross margin,” which only takes into account part of enterprise costs. Based on the enterprise survey data, Mr. Shan calculates a “gross margin”: “sales revenue” minus “cost of production.” This “cost of production” has risen faster than sales in recent years.

However, this cost category is only one of the cost categories listed in the enterprise survey data. Other cost categories—selling and distribution costs, administration costs, financial costs, and indirect taxes and fees—all rose slower than sales, and as a result total costs also rose slower than sales. Thus, taking into account all costs, profit margins are up, big time. As shown in the table nearby, average profit margins in industry increased to almost 6% in 2005 from less than 3% in 1999.

Mr. Shan neglects the effect that rapid turnover growth has on profits. By definition, total profits equal profit margin on sales times sales volume, and rapid economic growth boosted sales volumes in recent years. With both margins and turnover up, profit growth in industry averaged 36% in the period 1999-2005. Margins indeed came under pressure in 2005, but growth in sales was large enough to sustain still-respectable profit growth of 23% that year. Margins appear to have rebounded in the first half of 2006.

How can profit growth in industry have kept up with rapid increases in raw material prices in recent years? The answer is continued rapid productivity growth. As Mr. Shan also notes, labor productivity in industry grew at almost 20% on average since 1998, much faster than wages, which grew on average by about 14%. As a result, the share of output going

to workers declined to 17% in 2005 from 24% in 1998. In other words, enterprise profits increased its share of a very rapidly growing pie.

The rate of return on capital was not our object of interest, and was not important for our conclusions. There is no obvious relation between the amount of profit or the profit-to-GDP ratio and the rate of return. If financing conditions in a country are easy, we would expect that a high profit to GDP ratio is associated with a low rate of return. If the policy setting favors industry, e.g. through cheap land, energy, utilities and tax incentives from local governments, we would expect that a high profit-to-GDP ratio is associated with a high rate of return. In China, financing conditions are easy while the policy setting favors industry, but we do not know which of these two effects dominate. And it does not matter. What matters for us is the impressive increase in profits and profitability of Chinese enterprises over time, which shows up in data on all indicators: margins, profits and rates of return.

Data Issues?

WE RECOGNIZE THAT, despite recent improvements, China’s economic statistics still have many issues. But we are less concerned by problems with the profit data from the enterprise survey, because many other data sources confirm our main conclusions. We disagree with some of the problems Mr. Shan raises in his REVIEW article. First, subsidies to loss-making SOEs have fallen to levels too small to make a difference, and contrary to Mr. Shan’s understanding, investment income should be included in profit numbers. Second, the fact that survey numbers include taxes does not change our conclusions. The conclusion we derive from the enterprise survey data is that profits and profitability have increased over time. Our conclusions

on the size of enterprise saving are based on national accounts, after-tax numbers, not enterprise survey data.

Of course there are still a considerable number of loss-making enterprises in China, even if overall profits are up in the economy as a whole. However, the overall trend in the share of loss-making enterprises is clearly down. According to the National Bureau of Statistics' Statistical Yearbook data on Industrial Enterprises above a "certain" size, only 18% of all enterprises were making losses in 2004, the latest year available, compared to 28% in 1998. And whereas in 1998 the losses of loss-making enterprises still outweighed total profits of profitable enterprises, in 2004 the profits of profit-making enterprises were 1.1 trillion yuan (\$139 billion), almost 10 times larger than the losses of loss-making enterprises, which stood at 123 billion yuan (\$16 billion). So indeed, there are still loss-making enterprises in China, but on an economy-wide scale the story is one of rising profits, not losses.

SOEs are very much part of this profit story. The State-owned Assets Supervision and Administration Commission reported that for the first seven months of 2006 profits of the major SOEs totaled 497 billion yuan (\$63 billion), up 15.2% from last year, still outpacing GDP growth as they have done over the last several years. Figures released by the Ministry of Finance show that the profits of all SOEs in 2005 amounted to 905 billion yuan (\$114 billion), up 25% from the year before. The NBS enterprise survey data show that for SOEs the share of loss-makers fell to less than 35% in 2004 from over 40% in 1998, and that the loss of loss-making SOEs fell to 66 billion yuan (\$8 billion) from 115 billion yuan (\$15 billion) over the same period. Profits of profit-making industrial SOEs rose to 531 billion yuan (\$67 billion) from 52 billion yuan (\$6.6 billion) over the same period according to this source. According to the

Ministry of Finance, subsidies to loss-making SOEs have fallen over time and are now at 20 billion yuan (\$2.5 billion), or only 2% of total SOE profits.

Policy Implications

OUR INSIGHTS in saving, investment and profits have implications for policy. Three issues stand out: First, given that such a large share of investment is financed by enterprise saving and government transfers, monetary policy may not be as effective in reining in investment as sometimes thought. Second, the important role of internally generated funds in financing makes investment pro-cyclical: In good times, high profits ploughed back into new investment will further fuel activity, while in bad times subdued profits will hold back investment and activity. Third, the importance of retained earnings means that much of the financing of investment faces little outside scrutiny, since the decisions on financing projects are made by enterprise management rather than the financial sector. This may affect the efficiency of investment. Hence, we wrote in the August World Bank China Quarterly Update that "the continued investment boom warrants concerns about efficiency, making more moderate growth desirable."

Introducing a dividend policy for SOEs is a reform that can help both with improving the efficiency of investment and with addressing the macroeconomic concerns. First, this helps improve the efficiency of investment projects funded by SOE cash flows. Second, it helps improve the overall allocation of public resources. We have observed that the profits and profitability of SOEs have overall increased in the last decade, and that some SOEs make rather high profits. We think that this has made the case for an SOE dividend policy more pertinent. But our case does not rest on the level of profitability. ■



Japan Looks for Oil In the Wrong Places

by Masanari Koike



IN HIS 1975 novel *Yudan*, Taichi Sakaiya, the former chief of Japan's Economic Planning Agency, paints a terrifying picture of what happens when conflict in the Middle East results in a 30% cut in oil supply to energy-thirsty Japan. Entire industries go bankrupt. Three million die of hunger or fire. More than 70% of the country's assets are abandoned or destroyed in riots.

While the oil shocks that shook Japan in real life first in 1973 and once again in 1978 did not wreak as much havoc on society as depicted in *Yudan*, their impact on the lives of ordinary Japanese remains deeply etched on people's minds. Even today, the term "oil shock" conjures up images of shoppers rioting to buy essential goods, and memories of the sharp increases in consumer prices, which in some cases rose by as much as 20%. These oil shocks caused the Japanese economy to record negative growth rates for the first time in its postwar history.

Today, three decades later, the *Yudan* scenario is once again the center of attention among Japanese policy makers, who

are concerned about increasingly insecure supplies of foreign oil. In May 2006, the country issued its New National Energy Strategy (NNEs) in response to these worries. Yet this strategy fails to adequately address the serious challenges Japan faces in the global scramble for oil and how they might be overcome. Japan should rethink its energy diplomacy strategies and build a more competitive and integrated private oil sector. Instead of focusing on narrow, outdated geopolitical approaches to energy issues, Japan should use its influence to promote the use of oil markets.

Japan cannot function without imported oil. It was in part its lack of domestic natural resources that prompted Tokyo to embark on the disastrous territory-grab that sparked the Pacific War (1941-45). This plan was a failure, however, and in this respect it could be said that Japan's desire for oil was paid for with blood.

Even after the war, and up to this day,

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scarce domestic energy supplies have been a point of weakness in Japan's diplomatic relations. In recent decades, Japan has made some progress toward improving its energy security. It decreased its dependency on oil as a percentage of its total energy requirements to 47% in 2004 from 77% in 1973. It did this through conservation and diversification of energy sources. In addition, its public and private sectors currently hold oil reserves equivalent to 170 days of the country's consumption. This is greater than many other OECD members—for example, the U. S. holds approximately 83 days' worth of oil reserves. Despite those efforts, Japan's self-sufficiency levels for energy remain abysmally low, at 4%. This compares with 27% in Germany and 87% in the United Kingdom.

Clearly, the nation can never be fully free from the prospect of energy shortage. Given this, the NNES recognizes the importance of increasing the amount of oil developed and imported through Japanese producers (as opposed to non-Japanese producers) in order to improve Japan's energy security. The NNES calls for continued encouragement and support of domestic development of energy sources and a reduction in the country's dependence on oil by another seven percentage points to 40% of national energy needs by 2030.

However, the Japanese government still needs to clarify the reasoning behind the NNES by answering several important questions. For one, it should explain why it places priority on owning the rights to develop oil fields, rather than procuring oil on international markets. The administration should also debate whether such a stance could exacerbate global competition for energy, and should consider why previous Japanese governments which pursued similar policies failed. The Koizumi administration, for example, had to abolish the Japanese National Oil Corporation last spring because it had nonper-

forming loans to the tune of \$10 billion, which were accrued as a result of poorly planned and poorly executed large-scale oil exploration projects.

Several factors motivated Japan to release the NNES this year, despite insufficient reasoning behind some of the plan's targets. The first is the recent change in the supply and demand structure of the global oil market: Oil- and gas-producing countries have increased restrictions on foreign investment, while strengthening state controls over oil-resource development. For example, Venezuela, Bolivia and Ecuador have all recently moved to bring oil and gas fields under state control. Moreover, investments in upstream development projects are slow because of political instability in some producing countries, such as Iraq and Nigeria, and the reluctance of major oil companies to invest the increasingly larger amounts of money necessary to complete such projects.

On the demand side, energy consumption has risen steadily, due in part to an increase in demand for transport fuel in developing countries. Together with decreasing oil supplies, this has intensified competition over energy resources worldwide. The gap between supply and demand can also be attributed to different consumer preferences for heavy crude oil and light crude oil. While supply of the former is more abundant, demand is higher for the latter, partly because it is easier to refine into transportation fuel.

An even greater driver of Japan's NNES, however, is the threat from emerging competitors—most notably China. Beijing has invested more than \$12.5 billion in upstream projects in about 30 countries for the past five years, including in “controversial” countries such as Sudan, Syria and Burma. Moreover, the China National Offshore Oil Corporation (Cnooc) was the highest bidder for Unocal, a major U.S. oil company (though Cnooc was ultimately

unsuccessful in its bid). This development is indicative of the commercial buyout games and strategic considerations that govern the global oil market.

The tussle between China and Japan over oil and gas reserves in the East China Sea shows how rigorous competition over energy sources also can result in diplomatic disputes and deepen mutual mistrust between countries. Potentially huge reserves of oil and gas beneath the East China Sea have fueled a territorial dispute between the two countries, with both laying claim to the drilling rights. China has already started producing natural gas from the region—under the close supervision of the Chinese navy. Tokyo granted Teikoku Oil exploration rights to the area, but drilling has not yet begun because of security concerns. In this sense, Japan's decision to introduce the NNS also reflects an increasing sense of rivalry or nationalism.

WHEN IT COMES to the international market for oil, the cards are stacked against Japan for a number of reasons. Unlike China and other countries such as India, Indonesia, Malaysia or Russia, where oil companies enjoy financial and political support from their governments, Japanese private oil and trading companies do not have the benefit of such extensive government assistance. Thus, they cannot afford to expand their operations overseas. The Japanese government does, however, have a plan to expand its financial support to domestic private corporations through loans at privileged interest rates, direct investment and guaranties of liabilities, while working within existing business practice and regulatory frameworks. Unfortunately, this will not be enough to allow Japanese oil companies to compete. Compared with Cnooc and other state-supported oil companies in the region, Japanese oil companies tend to be small and are distinctly

divided between upstream and downstream players. It is to Japan's detriment that its oil industry is unable to enjoy economies of scale that might be gained if its supply and production chains were more integrated.

Japanese oil companies also face the challenge of dealing with rising costs and difficulty in developing new oil fields. There are not many economically feasible areas left within Japan to explore. Therefore, a company must go into a high-risk venture with low prospects of finding sizeable reserves. Researchers at the University of Tokyo recently concluded that the development and production costs of oil fields are increasing because the size of oil fields has diminished, plus the terrain is more difficult for drilling as the newer fields are often located in hard-to-get-at locations such as deep waters or the Arctic. The problem of soaring project costs is an especially serious challenge for Japan, given the country's current tight fiscal situation: Tokyo is running aggregate fiscal debts of more than \$9 trillion, making an additional increase in expenditure on energy development infeasible. According to a survey released by the Ministry of Economy, Trade and Industry this spring, more than 90% of small, domestic oil companies face difficulties in passing the increased production costs caused by rising oil prices on to consumers.

Another critical challenge is to increase the number of petroleum engineers working for Japanese oil companies. The capital of upstream industry was somewhat increased by the merger between Teikoku Oil and INPEX Corporation, one of Japan's leading energy-resource development companies, in April 2006. But this is still not enough. The debate over whether to create a "national champion" company completely ignores the even more fundamental need for petroleum engineers. The key, of course, is to increase human capital. While thou-

Increasing the number of petroleum engineers is vital, but this career is unpopular among the young.

sands of graduates go into the industry every year in China, there are only a few schools of petroleum engineering in Japan, and they are not popular among the young generation. Some Japanese experts estimate that China has approximately 100 times as many petroleum engineers as Japan. To compete with China and other countries, Japan needs the human capital necessary to support the expansion of its oil industry.

It is also crucial for Japan to get a grasp on the diplomatic dilemma that hampers its efforts to control energy supplies. State corporations or major multinational oil corporations retain the rights over most oil reserves in the Middle East, while the majority of other oil reserves in the world are in countries that are highly politically unstable. For instance, Japan is now concerned about acquiring interest in the Azadegan oil field in Iran, a country that accounts for more than 13% of Japan's total oil imports. With estimated oil reserves of approximately 26 billion barrels, Azadegan could prove to be an extremely important energy source for Japan. But Japan may have to reconsider working with Iran on this project, in light of Tehran's internationally unpopular stance on developing nuclear capabilities. Given Japan's adherence to the philosophy of nuclear nonproliferation and considering Tokyo's important relationship with Washington, it seems likely that Japan will not be able to pursue the opportunity represented by the Azadegan oil field.

So what is Japan to do? At home, a shake up of the Japanese oil industry's private sector is in order. Oil companies need to be more integrated both financially and operationally. In addition, the oil industry should cooperate with government and academia to expand its base of future engineers. On the international arena, the Japanese government should cooperate with energy producing and consuming countries to cool down the overheating market for oil. Joining the competitive hunt to "secure" resources will only add fuel to the fire. If it seeks to capture and fence off natural resources for its own use, the nation will not be released from the traumatic *Yudan* scenario. Strengthening market power, diversifying supply sources and mitigating international demand are modest but practical measures to address Japan's energy dilemma. With some of the most efficient and environment-friendly technologies in the world, Japan could share past lessons with consumers in other countries. Wider economic cooperation both with energy suppliers and consumers is also important. The U.S. is aggressively establishing trade and economic partnerships with countries in the Middle East, with a view to promoting economic development in several oil producing countries. Japan could use free trade agreements or Official Development Assistance to open markets and establish common links on issues such as energy-saving technology, infrastructure and democratization that facilitates cooperative relationships on other areas as well. ■



Japanese Capitalism Hits a Tipping Point

by Nicholas Benes

IT SEEMS TO have become commonplace for foreign newspapers to question whether anything fundamental ever changes in Japanese capitalism. Likewise, it has become almost customary for many Japanese commentators to lament that American-style global capitalism is in danger of ruining Japan.

In my opinion, neither is the case. While there is indeed gradual “convergence” in corporate governance practices between Japan and other developed nations, Japanese markets are also developing some unique features under their own domestic steam. Japan is not importing corporate governance practices willy-nilly, and core values are not entirely static either. This healthy evolutionary process is still in its early days, but has proceeded far enough that it is unlikely to stall.

This view finds support in the vast breadth of legal changes and merger and acquisition activity during the past three years, headlined by the new Company Law and takeover attempts by Steel Partners, Livedoor, Rakuten and Oji Paper, among oth-

ers. It is also suggested by the constructive debates and public awareness of governance that these events have sparked throughout Japan. During this period, there were more wide-ranging changes in public thinking and corporate practice than in any similar period in postwar history. A number of recent trends corroborate this.

First, there has been a significant increase in the number of outside directors on the boards of Japanese companies. Around 40% of the companies listed in Japan now have at least one outside director. While this number is still low—especially when compared to the U.S., where essentially all public companies have outside directors—nonetheless it represents a jump of more than 70% in the past 12 months. A marked increase in the understanding and acceptance of the role of outside directors seems to be underway.

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Second, since last spring the government has been enacting revisions of Japan's Company Law and major portions of its securities laws, based on principles of shareholder control, disclosure, transparency, accountability and investor protection. These concepts now appear in the media every day, and are increasingly understood and expected by the public.

Third, there have been at least eight takeover battles between December 2003 and September 2006, six of which involved unsolicited takeover bids—in a country where such events have been exceedingly rare. The government, the Tokyo Stock Exchange and the Pension Fund Association proposed rules for the fair use of takeover defenses, based on the principle of maximizing corporate value by ensuring objective decision-making that is free of conflicts. The result may not have been perfect, but not everyone agreed on the details, which was a good sign. Three important court cases kicked off the crucial process of determining the legality and sufficiency of these rules and clarifying their practical application: Livedoor/Nippon Broadcasting, a shareholder suit against process-controls firm Nireco and a suit by erstwhile acquirer Yumeshin. This constructive process is poised to continue.

Fourth, there were a number of highly visible arrests, suspensions, or prosecutions related to insider trading, disclosure or auditing violations. Casual foreign observers may fear that the government is focusing only on Takafumi Horie (the former CEO of Livedoor) and Yoshiaki Murakami, but in point of fact, it also went after Seibu Railway's famous Yoshiaki Tsutsumi, the former president and vice president of cosmetics firm Kanebo (for falsifying financial statements), their audit firm ChuoAoyama, UFJ Bank executives, Mitsubishi Motors executives, construction bid-riggers such as Yokogawa Bridge, and others. As a result of increased awareness, the general public

now reports suspicious circumstances to the Securities and Exchange Surveillance Commission almost six times as often as it did in the year 2000.

The full impact of these events will take years to seep through the system, and much still needs to improve. But the direction of future change is very clear. Japan is now a country where words like "accountability," "transparency" and "shareholders" are heard so often that managers must take notice. Their initial responses may be perfunctory, as is the case in any country, but are starting to deepen as they "talk the talk" about corporate value and shareholder returns.

Executives now have to deal with more vocal shareholders, and have seen examples of what can happen if they show the wrong attitude. They must keep in mind that the public no longer views all hostile takeovers as necessarily bad, because some of them could raise efficiency and value. In seeking to defend themselves, Fuji Television, Nireco and Hokuetsu Paper were criticized for using unfair tactics, lacking objectivity, or general sloppiness. Investor relations, disclosure, and shareholder meetings are all improving. Dividend payouts and stock buybacks are up, and companies are doing stock splits and paying quarterly dividends to make their shares more attractive to individuals. The number of *sokaiya* (racketeers who threaten to disrupt shareholder meetings) is at an all-time low. In addition, Japanese companies have started to space out their shareholder meetings, which up to recently have been on the same day in June, thus making it difficult for shareholders to attend multiple meetings and vote proxies. Now the number of meetings occurring on this peak day has declined to 1,590 from its high of 2,350 in 1997.

Japan's take on corporate governance is rooted in its cultural instinct to enhance efficiency by using clan-like organization-



Fund manager Yoshiaki Murakami faces the press shortly after charges were brought against him for alleged insider trading.

al structures to minimize wasteful transaction costs. Accordingly, the general reaction of many Japanese people to the U.S. system is that it must waste a lot of money and time—that there must be a better way than having all those lawyers and regulations. Shouldn't you be able to trust most good managers to do the right thing? Many would admit that this expectation is naïve. But it is driven by a cynical view of its own: that bad people will always find a way to be bad, and in a legalistic society more rules will always be needed to close the most recent loophole. There is also discomfort with Americans' knee-jerk tendency to use financial incentives to align managers' and shareholders' interests, because that could easily demoralize the employees who are left out.

In Japan there is a reflexive, instinctive fear that new rules and regulations may impair efficiency by adding more in terms of transaction costs than the value they preserve. At the same time, many people in Japan believe that it is far more important to have high ethical standards, intense concern for personal reputation and an excellent business philosophy. Otherwise, compliance will be superficial anyway.

There is a lot of good sense in this, but in practice both ethics and rules are needed. Concern about transaction costs lay behind many Japanese managerial practices that proved highly successful during the

postwar period, such as *shushinkoyo*, (career employment), smooth labor relations and employee participation in quality control. Understandably, therefore, when financial distress struck in the 1990s and concerns about governance first arose, executives were reluctant to disturb seemingly efficient institutions, such as the seniority system, by bringing on independent outside directors, a role that was not yet well understood. To remove all the internal board members who deeply understood the business would have felt like a risky over-reaction to a few corporate scandals that, after all, had occurred at other firms.

Many in Japan also believe that people are essentially good—especially in Japan, and especially if trained to have the right business philosophy and ethics. Personal reputation and fear of shame in a closely knit society like Japan are powerful forces, and were thought sufficient to motivate most managers to do the right thing. The concept of the individual was one per the Confucian or Buddhist model, not the Hobbesian one. Events not fitting this paradigm, such as Yamaichi Securities' demise as a result of accounting fraud, or the early phase of the banking crisis, were either viewed as exceptions or regulatory failures. And it was feared that the risks of tampering with corporate governance would be huge, as the process might destroy good aspects of the system.

But this was too idealistic. Overconfidence in existing practices, a holdover from the heady days of the 1980's when Ezra Vogel wrote *Japan as Number One*, was not sufficient to cope with the realities of the new low-growth era. Japan had become less homogeneous and closely knit (partly a myth anyway), and ethical yardsticks were more diverse. Policy also needed to consider that large companies with foreign shareholders, competing in a global marketplace, behave differently from smaller,

It became obvious that Japanese people are just as capable of squandering corporate value as anyone.

owner-managed companies. The rigor and philosophy that works at Canon is not naturally or easily replicated by another firm just because both are Japanese.

Consistent with this instinct to minimize transaction costs, until recently shareholder activism, shareholder proposals, external nominations of directors, and proxy battles were rare. Before the bursting of the stock market bubble, activists and aggressive acquirers alike were regarded as such renegades—and cross-shareholdings and stock prices were both so high—that serious bidders could get no traction. Institutional investors had no one to back.

But during Japan's so-called "lost decade" both the man on the street and Japanese bureaucrats realized that the idealized view of Japanese capitalism had become riddled by too many exceptions to ignore. These exceptions had been hidden by fast growth during the 1970s and 1980s, but they were vomited up repeatedly during the 1990s. It had suddenly become obvious that Japanese people are as capable of squandering corporate value as anyone. It was no longer credible for executives to assert that traditional governance practices were based on immutable Japanese "values" and were working well, when in fact Japanese companies and managers were clearly a diverse lot. Some of them certainly fit the ideal pattern, but others fell short, and had caused huge financial losses.

Thus, governance became an area targeted for *kaizen*, or process improvement, by Japanese companies and regulators. Starting around 1999, the government began to improve legal and regulatory systems for corporate governance, disclosure and securities transactions, in what can only be termed a major overhaul. Just keeping up with this torrent has become a

major challenge for lawyers, accountants, consultants and executives—albeit a boon also for the first three. I do not think that Japan will suddenly lose this momentum. Indeed, many of the legal changes have only just been instituted, and their full impact will occur later.

Now that the tipping point has been reached, what will happen next? What are the challenges and milestones to watch for? Over time, institutional shareholders will become more vocal and less afraid of supporting a growing group who perform some sort of activist investor role. Though still insufficient, greater attention to fiduciary duty in voting proxies is now expected of institutional investors, who feel increasing safety in numbers. As long as untapped value and potential to boost returns persist, activist investors will continue to be attracted to the market despite the prosecution of Mr. Murakami on insider trading charges. As proof, note that new funds are still being formed. Activists and acquirers today are well aware that under the new Company Law, it is easier to have impact because a vote by 51% of a shareholder quorum is now sufficient to change the entire board.

Meaningful dialogues between managers and investors will increase, leading to improvements in governance practices and board composition, and ratcheting up pressure on executives to focus on core business segments. M&A activity and industry consolidation will accelerate. Already, the number of M&A deals per year is four to five times what it was 10 years ago. M&A activity as a proportion of GNP is approaching the level of other major developed nations, and takeover bid volume has exploded in the past year.

In the next few years, court cases will

clarify important questions such as “what is the appropriate use of takeover defenses during a contested takeover?” or “what is director liability in such situations?” Some of the legal yardsticks the courts devise will be different from those used in Western jurisdictions. For instance, they may strike a different balance between corporate stakeholders, or accord a different level of discretion to directors.

If investors decide that these yardsticks are not the correct ones, this will add impetus to calls to include more independent outside directors. As responsible proxy voting becomes more common, such calls will become harder to resist. Different from the U.S., shareholder proposals to nominate directors must be included in the proxy materials at no cost to the proposer, and hence will be voted on by all shareholders.

It is possible that Japan might come up with some new solutions at the intersection of management efficiency, accountability and shame-driven morality. But Japan's capital market will not reach the respected level of New York or London until it corrects its double agency cost problem, which is the largest gap in investor protection in Japan. This refers to the fact that fiduciary duty is needed not only from managers (the first level of agency cost), but also from the institutions that are watching over them (the second level). Despite increases in responsible proxy voting by foreigners and domestic mutual funds, most Japanese banks and insurance companies are still virtual “yes-men” to managers because they fear losing their banking and insurance business. The meek stance of these so-called “stable shareholders” is the main reason why poor managers are not routed, why valid activist critiques can be resisted, and why there has never yet been a single successful hostile takeover in Japan.

The best way to fix this problem and invigorate markets would be to adopt a secu-

rities class-action system, complemented by a system of discovery to uncover evidence. Japan's shareholder derivative lawsuit system is not sufficient. South Korea recently implemented a securities class-action law, and even Taiwan has a hybrid version. If Japanese managers felt more exposed to the risk of personal liability, court costs, or embarrassing disclosures, in many cases they would not ask stable shareholders to support unjustifiable positions in the first place. They would be forced to analyze more and compromise more.

At this tipping point, Japan's capital markets are being tested. Even if the direction of change is now clear, there is no guarantee that it will occur as fast as we might like. Activists are starting to have an impact, but are still often confronted by overly stubborn, hard positions when they employ a less-than 100% friendly approach. Often, greenmail is the result. To prevent this, internal pressures—e.g., director liability concerns—are needed just as much as the external voices of investors.

So from this angle as well, the next big positive signal to look for is a government commitment to better protect consumers and investors by creating systems for evidentiary discovery and class-action lawsuits. It is conceivable that a truly reform-minded prime minister would put this back on the agenda in a few years; after all, the Legal System Reform Council considered it in 2001. But more realistically, another spate of highly visible scandals, dangerous product recalls and governance failures will probably need to occur first.

With a class action system in place, Japanese corporate governance would improve several times faster than otherwise might be the case. The design features that Japan would no doubt use to preserve efficiency by limiting spurious suits and abuse might even be instructive for other countries. ■



China's Online Mobs: The New Red Guard?

by Anne Stevenson-Yang



SINCE THE ADVENT of a commercial Internet in China, observers have debated what its impact on society would be. Would the Internet democratize China? Could the Communist Party control the Internet as they control other mass media? It turns out that these are the wrong questions.

Chinese authorities long ago abandoned the idea that they would “control” all the information flowing over the Internet. But they do reserve the right at any time to appropriate channels of communication to promote any of a wide range of mandates, from protecting the value of Chinese assets exposed to global capital markets, to preventing unauthorized political organization. No Fourth Estate can be allowed to obstruct these agendas.

This lack of independence has helped create an Internet in China where fact and propaganda, advertising and editorial cannot be told apart. One result is that suspicious Chinese users are drawn to the “authenticity” of personal communication: chat, blogs, and video and photo swapping. These users’ stampede to chat

rooms and networking sites has engendered an Internet unusually prone to a mob mentality.

The activities of chat room “nannies,” people employed by websites to keep watch for politically deviant discussions, are much discussed. Less understood is the pervasiveness of commercial propaganda on China’s Internet. News, especially business news, is often bought outright by arrangement with journalists, and a cottage industry of public relations firms has grown up whose core competence is “soft” bribes, like outings and gifts, for journalists.

Apart from payments to individuals, companies can buy “soft copy” directly, and many websites employ a staff expressly to write PR for paying customers and run it as news. Chat rooms are “hosted” by commercial sponsors, who pay for the right to answer questions and make recommendations under cover of being just another concerned consumer. Marketing plans, es-

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pecially those for products aimed at young people, now frequently involve launching a blog to extol the product's virtues from the point of view of a "consumer."

Commercial Barriers

ADVERTISERS CAN HARDLY be blamed for using guerilla marketing tactics however, because regulatory constraints make formal advertising channels inefficient. Advertising licenses are still difficult to get, and the bar is high for foreign-invested companies that want to operate agencies, while companies may advertise only those products and services that are within their approved business scopes. When companies buy advertising, they have very little information about either the number of readers or viewers they are buying or their demographic or psychographic profiles: all of media regulation works to ensure that media operators cannot access their audiences directly. In broadcasting, programmers may not see the list of cable subscribers, even on a statistical level, and even the state broadcasters cannot say how many people watch which station or program. Private companies like market research firm A.C. Nielsen measure viewership, but their reports are proprietary and very expensive.

On the Internet, there is no audit process nor standards for determining what should count as "traffic," and as a result, reported traffic numbers are hopelessly inflated. For example, U.S. Internet companies typically do not report visits of less than five seconds as part of their traffic—such short visits probably represent an automat-

ed search engine "robot" combing the Internet for key words, or maybe a pop-up advertisement that no one asked to see. In China, these are fair game, so Internet operators can generate as much "traffic" as they are willing to pay for by buying ads that pop up on search engines.

The story of success in China's media market is the story of finding ingenious strategies to get directly to the consumer. Companies like Target and Focus Media started with glossy books of advertising delivered free to consumers' doors. Then

there are those ubiquitous advertisements that blare from

giant LCD screens atop high-rise buildings.

And before it became regulated,

the use of Short Messaging System (SMS) advertising

was also hot. For print publishers, the Holy

Grail is a distribution partner with a captive

channel—a soccer club that will

give away a sports magazine with membership, a bank that will distribute a finance magazine at its branches, and so on. In each case, success flows from the direct control of distribution by the media operator.

In China, paid or subscription content is virtually impossible to sell, partly because of the piracy problem. Every Web site operator and journalist knows that any interesting article or photo will be instantly copied by other sites, often with modifications and without attribution. As a result, there is little incentive for media owners to generate interesting original content. Instead, they hire teams of editors who seek out content they can cut and paste onto their own sites. Not surprisingly, if you can't protect your content, you also cannot have content distinctive



FRED HARPER

China's stampede to chat rooms and networking sites creates an Internet prone to a mob mentality.

enough to appeal to a really clear demographic niche. Web site operators simply work to pull in as many people as they can through whatever means. Even when sites want to accept the various risks associated with original content, they will need to skate close to the regulatory boundaries. Strictly viewed, media companies that are not owned by the government have no right to generate original content.

Another problem for those who would follow a subscription content model is that getting permission to accept payment online is bureaucratically far more difficult than operating a free information site. Licensing difficulties make goods and services difficult to sell online. To take a simple example, a software company that has the right to sell its software will very rarely be able to obtain permission to operate an "e-commerce Web site." Without that permission, the company may not sell its software online other than through agents, losing control of its distribution channels.

The speculation that currently drives so much Internet growth further exacerbates the rush for traffic. Valuations for Internet sites whose traffic doubles monthly far surpass any realistic expectation of revenue—and it doesn't matter, because there is always a capital investor to help the founders cash out. The money has gotten smarter since 2000, but with market capitalization running about 100 times earnings for companies like Baidu, one of the most popular Chinese search engines, it pays to lay high-stakes bets.

Advertisers know numbers are inflated, and site operators are pressured to provide more value, so they seek non-traditional means of generating income. Often this results in event management and sponsor-

ship as means to obtain revenue. Many sites in home renovation and electronics, for example, make their money by organizing consumers into buying groups and then taking commissions from the retailers. Other sites with enough traffic to justify high prices are in the business of selling their "channels" to companies that want to supply content. Likely as not, the channels are bought by companies packaging their commercial pitches as objective information—an English-language training company, for instance, will rent a portal's "language training" channel and be responsible for all information on it, with obvious resulting conflicts of interest. The successful portals generally charge around \$32,000 per year to host and link content from other sites. Smaller sites might charge only \$13,000.

Advertisers do not need to go so far as to take over the content for a whole channel: Most Internet sites and virtually all print publications have a "soft editorial" staff dedicated to writing articles extolling the virtues of a particular type of ketchup or wooden flooring in return for payments. This is actually an innovation. A few years ago, such articles were written in exchange for corrupt payments. The system became so common and so widely known that it was drawn into media companies and became a normal part of business operations. This is not to say that under-the-table payments for editorial promotion are not still common; they are in fact the rule. Newspaper editors will tell you that, if you hold a press conference, there still must be at least \$25 in an envelope for each journalist who attends. But you can no longer expect that the journalists from the more successful publications will file uncritical reports—that costs more.

Beware China's Yellow Journalism

THE WAY INFORMATION is managed for propaganda reasons also promotes a mass dynamic on the Internet. Subjects of discussion are essentially divided into three categories: topics on which all information must be directly issued by the Party's Propaganda Bureau, such as policy edicts and personnel announcements; topics that must be viewed and censored by the Propaganda Bureau, such as major national and international news events; and topics that are subject only to general guidance principles (no mentioning leaders' personal lives, no mention of ethnic or racial prejudice, etc.). The majority of Internet content falls into the last category and so is subject mainly to self-censorship.

Political management of information content around topic areas seems to have pushed some political or nationalistic sentiment into subjects that would normally not seem to inflame patriotic sentiment. When you are not permitted to say, for example, that you think China should oppose Japan's application to join the Security Council, then expressing your outrage at a Japanese movie can be a stand-in for your political sentiment. So, it is probably not a coincidence that the cultural wildfires Chinese call "Internet hunting" often break out around topics that seem very personal. One recent blog storm stirred around a college student who called himself Bronze Moustache and claimed to have had an affair with a married woman. Public outrage ensued, and Howard French of the New York Times reported in June 2006 that even long after the husband had begged Netizens to leave Bronze Moustache alone, saying that the rumor of an affair was false, the student was still being pursued and persecuted both online and—following the publication of his name and address—offline.

Inevitably, the propaganda authorities have also discovered the value of guerilla marketing. There is no published information on how many government-sponsored agents post information on China's Internet, but the government publicly promotes a program of chat room propaganda in localities nationwide and estimates several tens of thousands of agents take part. Certainly, the average Chinese citizen thinks that political dissent will be noted promptly by ubiquitous authorities and many people fear government entrapment online in conversations about democracy, Japan, religion and other sensitive topics.

This regulation creates an environment in which everyone is role-playing. Companies pretend to be your friendly online advisor. Media operators pretend to be objective presenters of the news. True reformists or dissidents might use discussion of a film as a surrogate for political debate. Government agents pretend to be dissidents. Journalists pretend they are independent. In the end, everyone suspects everyone, and even sincere motives are questioned. Try this next time you are in China: ask a Chinese acquaintance whether he or she believes the weather report. Many Chinese believe that the government lies about temperatures that are too high or too low, because some state-owned companies are supposed to pay subsidies to workers on very hot days.

What was to the authorities perhaps the most alarming brushfire on the Internet came in spring 2005, when Japan's issuance of a new textbook that airbrushed Japanese atrocities in China, concurrently with Japan's application to join the UN Security Council, led a couple of websites to post a petition to boycott Japanese goods. In an exquisite segue of political and commercial interests, dozens of websites copied and pasted the popular petition, both demonstrating their patriotism and bringing traffic over to their own sites. Very quickly, the

online indignation led to offline marches in Shanghai, Beijing, Hangzhou, Tianjin and elsewhere, until the panicked government made a show on one hand of its patriotic support for the students and alerted media, on the other hand, not to publish anything more about Japan.

In the U.S., people don't really get on the Internet to engage in general discussion. Instead they use tools like online banking or stock trading, or seek information from authoritative sources (such as the New York Times, The Wall Street Journal, etc.), which not only host rich and income-producing websites but license their content to others as well. But China's Internet has developed an entirely different dynamic. It functions as a great public square in which the masses debate from virtual soapboxes, a forum whose very oxygen consists of the deep mistrust Chinese people have for any information from non-government sources. The free-ranging suspicion of all professionally generated content inclines Chinese Internet users to the "authenticity" of unfiltered chat.

Managing the Mobs

WHERE VOLUME MEANS commercial success, the stakes are high for those who might turn an Internet "mob" in their own direction. In the absence of a segmented Internet, offering authoritative content to specialized user groups, China has developed an online mob dynamic in which a blog can fuel a sudden social fire, which then becomes subject to the autocatalytic effect of mass copying by sites who want to participate in the traffic surge. The irony is that the peculiarly Chinese "Internet posse"—people who try to identify, pursue and seek justice against those of whose postings they disapprove—would seem to be a byproduct of the government's effort to control precisely the distributed aspect

of Internet communications that is viewed as so threatening to the Communist Party's rule. Outspoken Chinese media themselves have compared the radical mobs to the gangs of Red Guards during the Cultural Revolution.

The traffic spikes so valuable to Internet operators create much the same dynamic that drove the circulation wars between the Pulitzer and Hearst empires in New York in the 1890s—the period which gave birth to the term yellow journalism. Online China offers a fascinating commingling of high and base motives, of commercial gain and telling-truth-to-power. But the newspaper wars of the Gilded Age—and, incidentally, of the early 1990s in China—were driven by the opinionated editorialists who gave distinct voices to their publications. The newspapers may have whipped up public sentiment, but they could not directly organize it.

Online China is a little different. In the absence of trust in "formal" news or information, Chinese Netizens act essentially like bees, swarming to whichever bulletin board system (BBS) or chat room has the most people and the most intriguing conversation. BBS traffic is fickle and is happy to follow scandal to the next site, as long as others are there as well. The fates of sites like Bokee, Newsmth, Ziming, and Tianya rise and fall with the fashions of the month, because the one thing you cannot fake (at least not completely) is BBS traffic—each chat room lists the number of people currently in on the discussion. So BBS traffic, the lodestar of any Internet entrepreneur, is by nature fickle and scandal-seeking. What is especially interesting about the Internet, though, is that the customers are there to communicate with one another. That is why it does not take a leap of imagination to think that hot chat rooms could easily jump off the screen to become real-life conflagrations. ■



THE FAR EASTERN ECONOMIC REVIEW'S Barometer of Asian Development

by Alvino-Mario Fantini and Hugo Restall



ASIA IS DOING something right—its boom has raised hundreds of millions of people out of poverty. Yet debate still rages over how the region's economies can maintain high growth rates and competitive business environments.

All sorts of theories have been propounded—from cultural values to geographic reasons to economic characteristics—to explain the phenomenon of the East Asian miracle. In their analysis of the economic performance of Asian countries, economists ask, “What are the

most important prerequisites for economic development?” Strategic investors, on the other hand, want to know, “What factors indicate whether an economy is going to grow quickly?” And some portfolio managers simply want to know, “Where are the highest returns found?” The REVIEW Barometer of Asian Development takes a fresh look at all these questions.

We know this may seem presumptuous. Plenty of highly educated and smart

~ Mr. Fantini is a London-based writer and development consultant. Mr. Restall is editor of the REVIEW.

people have already tried to address these questions with complicated formulae, in-depth surveys and mathematical models, in an attempt to rank countries according to their wealth-creating environment. From competitiveness to investment flows to political liberties, existing indices (or rankings) provide snapshots of national economies for global leaders. Some of these include:

- *The Global Competitiveness Report, produced by the World Economic Forum.*
- *The FDI Confidence Index and the Global Retail Development Index, created by A.T. Kearney.*
- *The World Competitiveness Yearbook, published by the Institute for Management Development.*
- *The World Business Environment Survey conducted by the World Bank.*

These indices contain plenty of useful information, and indeed we used some of their publicly available data points. Be-

cause they focus on different factors or qualities, individually, they offer glimpses into a country's competitive strengths and weaknesses.

However, the problem is that much of this information is already priced into the market. For instance, everyone knows that Japan (ranked #8 by WEF and #21 by IMD) is generally a better place to do business than, say, Indonesia (ranked #44 by WEF and #59 by IMD). Global investors have certainly acted accordingly and, as a result, Japan has become a wealthy country while Indonesia has yet to even take off from the launching pad.

Thus, these indices—typically constructed on the basis of surveys or commonly accepted data on, say, factor accumulation, foreign direct investment levels, productivity, and the like—run the risk of merely confirming what business leaders and investors have seen in the marketplace. So when we look ahead to the fu-

BAROMETER OF DEVELOPMENT 2006												
	Australia	China	Hong Kong	India	Indonesia	Japan	Malaysia	New Zealand	Philippines	Singapore	South Korea	Thailand
HUMAN FACTORS												
Education (10)	5	5	10	10	10	5	-10	10	-5	5	10	10
Human Mobility (5)	5	5	5	5	-5	5	-5	5	5	5	5	5
Dependency Ratio (10)	0	10	5	5	5	5	5	5	10	5	5	10
Gender Equality (5)	5	-5	5	-5	5	5	-5	5	5	5	5	5
MARKET INCENTIVES												
Energy Market (5)	5	5	5	5	0	0	5	-5	5	0	5	5
Housing Market (10)	10	5	-10	-5	-10	0	0	10	0	0	5	0
Labor Flexibility (5)	5	5	-5	0	(1)	5	(1)	5	-5	0	-5	5
Creative Rights (10)	5	10	10	10	5	0	5	0	0	5	10	10
MACROECONOMY												
Aid Dependence (10)	0	5	0	10	10	0	-10	0	10	0	0	10
Creative Destruction (5)	0	0	5	5	(1)	-5	5	5	(1)	0	-5	0
Capital Access (10)	-5	0	0	-5	0	0	-5	5	-5	10	-5	-5
Regulatory Burden (10)	0	5	-5	0	5	0	0	0	5	10	0	0
GLOBAL INTEGRATION												
Communication Costs (10)	0	10	5	10	10	(7)	10	-5	10	7	10	10
Logistical Matters (10)	5	5	(4)	5	5	4	5	5	0	5	0	5
Antiglobalization Sentiments (5)	-5	5	0	-5	-5	-5	-5	-5	-5	5	-5	-5
Openness & Tolerance (5)	5	0	5	0	0	5	0	0	0	5	5	5
TOTAL FACTOR POINTS: 125	40	70	39	45	37	31	-4	40	31	67	40	70
FIGURES IN BRACKETS REFLECTS FACTORS WITH NO DATA, AN AVERAGE OF THE OTHER COUNTRIES' SCORES WAS USED.												

ture and try to anticipate trends, it is difficult to rely on them to get beyond the conventional wisdom.

A Fresh and Fun Approach

IF YOU JUST want to know which countries are poised for rapid growth, look to the savings rate. Where a high percentage of national income is being invested rather than consumed, GDP is likely to soar. However, high savings also depress returns on capital, meaning such countries are not necessarily the best place to invest. Moreover, if the savings fund unproductive investments, the results can be catastrophic, as Asia learned in 1997. The question then is which countries will grow consistently.

Any index, no matter how scientific it claims to be, is bound to be subjective. The decision to include certain factors and exclude others is, in itself, a matter of choice. So we'll be forthright about our own point of view: Sustainable growth is built on openness to competition both domestically and internationally, and the cultivation of human talent and management. Prosperity comes when governments (and international institutions) get out of the way of private enterprise—not when they try to micromanage development.

Determining who is best positioned for such growth is a tall order indeed. The debate over the determinants of economic growth has shed more heat than light, so we've decided to step back and take a fresh and fun approach. We took factors which serve as proxies for a country's preparedness for globalization to see if we might beat the econometricians and statisticians at their own game.

When it comes to trying to predict future opportunities, relative changes are often more meaningful than absolute levels. In other words, looking at an indicator's trend line gives us a better sense of how open a country is to change.

In our Barometer, then, countries are scored on the change in the data over the last five years, not on the basis of the latest numbers. Thus, for example, if a country's performance in a given area remains unchanged, it will receive zero points for that factor. Improvement or deterioration of a factor warrant a positive or negative score.

This emphasis on relative change removes the difficulty associated with comparing countries at various stages of development. It also eliminates the need to find data that has been compiled using perfectly consistent methods and allows us, as it were, to mix some apples and oranges depending on what data is available.

The REVIEW Barometer is designed to be a thought-provoking exercise rather than an all-inclusive ranking of countries. We are skeptical of the idea that a country's competitiveness can really be reduced to a single number. In other words, the final number for a given country included in the Barometer may not be as useful as considering each of the factors by which it is composed. In fact, while we chose our factors as leading indicators of change in a given economy, we also chose them because their importance tends to be underappreciated.

Just as a barometer is a sailor's rough guide of the sea ahead, we hope to build and refine the REVIEW Barometer into a tool that helps businesspeople chart a course through the region's often uncertain economic waters.

A full introduction to the methodology and data of the Barometer is available at www.feer.com. Here is a brief introduction to the factors:

● **Education (10 points)** High levels of literacy and numeracy are essential to development. However, the importance of tertiary education is often highly overrated, particularly when students are not paying the costs themselves. The most

important task of education policy is to provide workers with a basic education so that they are trainable. Efficient firms can then school them in the techniques needed to achieve world-class productivity. So we have looked at primary and secondary education funding and completion rates as positive factors, and spending on tertiary education by the state as a negative factor.

● *Human Mobility (5 points)* A country with a competitive economy normally attracts laborers, while an ailing economy sees the best and the brightest “voting with their feet” as they go abroad to look for opportunities.

● *Dependency Ratio (10 points)* The standard dependency ratio serves not only as an indicator of how quickly a society is aging, but also as a measure of how dynamic and elastic the labor market is.

● *Gender Equality (5 points)* An economy is not using its full complement of human talent if it does not afford opportunities for women to move into leadership positions.

● *Energy Market (5 points)* Unexplained losses in distribution or transmission of electricity reflect inefficiency, corruption and poor protection of property rights.

● *Housing Market (10 points)* Regulations concerning a country's real-estate market are a proxy indicator of property rights and the rule of law. The ease with which a person can register a property also indicates the level of bureaucracy.

● *Labor Flexibility (5 points)* By looking at youth unemployment, we gain an idea of how flexible is the labor market.

● *Creative Rights (10 points)* When a country's population is dynamic, skilled, creative and, most importantly, free to invent, create and innovate, the level of patents and copyrights should necessarily reflect this. These also reflect the perceived reliability of intellectual property

protection.

● *Aid Dependence (10 points)* High levels of multilateral or bilateral aid tend to encourage corruption and create incentives for policy makers to take the easy road of insulating politically influential industries from competition.

● *Creative Destruction (5 points)* Putting aside the influence of the business cycle, a higher level of bankruptcies is actually a positive indicator, since it shows that market exit is possible, allowing more efficient firms to gain market share. It can also be a sign of entrepreneurial activity.

● *Capital Access (10 points)* The vco Online database and the Capital Access Index from the Milken Institute measure access to venture capital.

● *Regulatory Burden (10 points)* The number of steps (and days) necessary to build a warehouse, as well as the fees to start a business, show the level of regulatory barriers to entry.

● *Communication Costs (10 points)* The price of an international call, and the price and speed of a courier delivery show the level of competition in these critical industries.

● *Logistics (10 points)* The efficiency and activity within the ports shows connectedness to the global economy, as well as the level of regulation and competition.

● *Antiglobalization Sentiment (5 points)* The number of delegates a country's leftist groups send to the annual World Social Forum, the anticapitalist version of the World Economic Forum, and other measures of these groups strengths show the level of resistance to economic development.

● *Openness and Tolerance (5 points)* The work of Richard Florida has highlighted the importance of welcoming creative people for a dynamic knowledge economy. One simple indicator is the number of restaurants and bars listed at a gay portal such as www.fridae.com. ■



REVIEWS



CHINESE LESSONS: FIVE CLASSMATES AND THE STORY OF THE NEW CHINA

by John Pomfret

Henry Holt, 336 pages, \$26

Reviewed by GRAHAM EARNSHAW

JOHN POMFRET, FOR several years the Washington Post bureau chief in China, wanted to write a China book, of which there is currently a veritable flood. He needed a new framework for it, something other than another "The Real China by yet another foreign correspondent" and he came up with a great one. Mr. Pomfret takes a group of people, history graduates from Nanjing University in 1982, and follows them through the next two decades of their lives, reflecting the times, trends, contrasts and progress of China through the fate of a few individuals.

He was able to do it because he was one of a handful of foreigners studying at Nanjing University way back in the early 1980s. The Chinese characters in the book were his classmates, with whom he managed to maintain contact through all those years. He takes it pretty well chronologically, beginning with an introduction to his own arrival in China and to his classmates:

At six o'clock in the morning of February 3, 1981, I awoke with a start to the sounds of drums, trumpets, and the squawk of a woman telling me in Chinese to "increase vigilance, protect the motherland and prepare for war!" This woman would hound me for the next year, her disembodied voice blasting out of a tinny speaker dangling by a wire just far enough from

the bottom bunk that I could not disable it with a broom, yet close enough to wreck my mornings.... Around me, seven Chinese men, ranging in age from eighteen to mid-thirties, all dressed in blue long-sleeved T-shirts and long johns, rustled out of their cotton bedding. As if on cue, they sent up a chorus of phlegmy hocks.

The story is made gritty by such references to the (pardon me) real China. After an introduction to the characters, Mr. Pomfret leaps into Cultural Revolution stories. At this point, I was feeling déjà vu-ish—I have read so many stories over the years about desperate acts of violence and exile during the Cultural Revolution and I was worried that this book would be just more of the same. But Mr. Pomfret pushed through it and we emerge before too long (maybe a little too long) into new territory—the story of the past two decades and more since Deng Xiaoping changed the course of history, pulled communist China out of a death dive and opened up the country.

Mr. Pomfret's classmates—the ones that are featured—luckily cover a lot of the ground in terms of what has happened to China since those now far-off days. One of them becomes a government official, another an exiled sportswriter, a third a businessman. Mr. Pomfret uses the material well, and reports on what happened to his classmates with compassion and an eye to the wider significance of personal events.

These people are not totally representative of China, of course. This is not a criticism, just a statement of fact. Anyone who

Mr. Earnshaw is publisher of *China Economic Review* magazine.

was attending university in 1982 was relatively blessed. The schools had been reopened for only a short while, following the complete breakdown of the education system during the Cultural Revolution. A whole generation of people failed to get into university and had their lives ruined in the process. This story is not about them. Most people in China never get to go to college—even less than now. This story is about them only in an indirect way. The ones who were in university in those years had the opportunity to rise fast, emigrate early and generally excel in the Chinese race of life.

The result is a book that provides a perspective on China today which is personalized and memorable in way that collections of economic statistics and predictions would not be. The lady Little Guan sounds like an interesting and vivacious person and I would like to meet her. Mr. Song, the sports writer, sounds like someone who would be fascinating to have a drink or a meal with.

The historical approach to analyzing China cannot go on forever, however. There has to come a day when the Cultural Revolution is put behind us, and books like these are more about China today than China yesterday. But if the end of the trend was to be *Chinese Lessons*, we could do a lot worse.

One of the classmates whose story we follow is Mr. Pomfret himself. It's hard to know how much of himself an author should put into a book of this kind. Mr. Pomfret puts in quite a lot, but it is still significantly less navel-gazing than some similar books published in recent years. And the reader is rewarded by being invited into the life of Mr. Pomfret with

some great stories. There are the tales of Mr. Pomfret looking for and finding China romance; of Mr. Pomfret dealing with noodles and officials; of Mr. Pomfret in the middle of the madness of Tiananmen Square in 1989. Tiananmen is a key section of the book, and Mr. Pomfret has a unique perspective on what went down in that extraordinary episode.

I was a journalist in China from 1979 through much of the 1980s, and I am envious of the opportunity that Mr. Pomfret had to create relationships with ordinary Chinese people in the early 1980s as a result of his student status. As an accredited

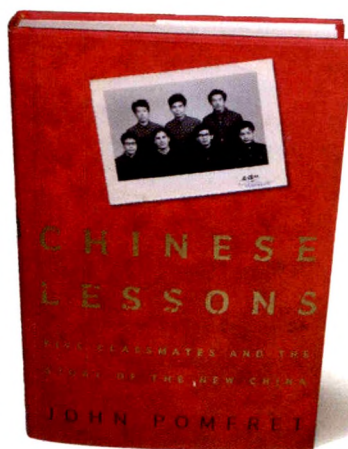
foreign journalist, I was heavily restricted, at least after the death of Democracy Wall, in terms of meeting local people. I am also envious of his Tiananmen involvement. I was there on the night, but missed much of the lead-up. Given his excellent Chinese language capabilities and reporter genes, Mr.

Pomfret became one of only a handful of foreign journalists to really burrow into the story.

His account in *Chinese Lessons* is one of the best June 4 memoirs I have read.

Mr. Pomfret is a classic cynical journalist, and during his time as Washington Post bureau chief in Beijing, he was in my opinion the best general news foreign journalist operating in China. If, at the time, you read all of Mr. Pomfret's reports out of China, you would have had a good sense of what was going on in the country without necessarily reading any other material at all.

His views on China then and now are pungent and generally accurate, although I would say somewhat overly negative. Shopping malls are a part of China becom-



ing a part of the world, after all. But this kind of comment is absolutely spot-on:

For centuries, Chinese debated what it was to be a good person, a good citizen: What was the Good, the Virtuous and the Right? Fifty plus years of Communist censorship and political campaigns have silenced those debates, and it is still unclear whether the country has the ability to revive the tradition of asking these timeless questions. China has had a great run since the Tiananmen Square crackdown, almost two decades of political stability and a rate of economic growth unparalleled in modern history, but that is coming to an end. Peasants and workers are increasingly restive. The social contract hashed out by Deng—you can get rich if you keep your mouth shut—is fraying because too few people have won their share of the bargain.

All true. Except that overall, I would tend to put a more rosy hue on the result of all this change and upheaval. Since 1982, China has moved from darkness to light, from zero freedom to selectively restricted freedom. The fraying is defrayed by rising living standards, and all the characters in *Chinese Lessons* end up better off than they could ever have hoped in 1982. Including, probably, Mr. Pomfret.

SACRED GAMES

by Vikram Chandra

Faber and Faber, 900 pages, £17.99

Reviewed by SALIL TRIPATHI

FOR A LONG time, the uncrowned king of writing about Bombay has been Salman Rushdie. From the time he used magical words to describe the city of his birth in *Midnight's Children*

(Knopf, 1981), he has continued to return to its charms, in *The Satanic Verses*, *The Moor's Last Sigh*, and *The Ground Beneath Her Feet*. However far he strays from the city, his novels are not complete without references to Bombay.

In the post-Rushdie generation, two writers in particular have focused on Bombay: the Canada-based Rohinton Mistry; and the U.S.-based Vikram Chandra. Mr. Mistry's fiction is solidly researched and extremely popular internationally, but his characters lack a third dimension and it is difficult to empathize with them. When his characters speak eloquently about the "multi-everything" spirit of Bombay's inclusiveness in *Family Matters*, for example, they sound like they are delivering speeches from a pulpit, and the prose simply doesn't have the moving, emotional appeal of Mr. Rushdie's. Mr. Mistry's characters say they love the city; Mr. Rushdie's characters love the city, and they don't need to say it.

It is in that context that Mr. Chandra's arrival with a big fat novel about Bombay is most welcome. *Sacred Games* is Mr. Chandra's second novel—his first work, *Red Earth on Pouring Rain*, had a lyrical charm and it has been over a decade since then for another novel from him. The wait has been worthwhile. In between there was an elegant collection of stories, *Love and Longing in Bombay*, that showed five different sides of the city—including its rich, its criminals and its underdogs—while also forming a cohesive whole. In those stories, we met a sardonic Sikh police inspector, Sartaj Singh.

In *Sacred Games*, we meet Sartaj Singh again, now divorced and corrupt in a non-spectacular way. He is meandering his way through his life at a police station, using

∞ Mr. Tripathi, a former Singapore correspondent of the REVIEW, is a writer based in London.

*Mr. Chandra's characters are at home in the periphery
that is fast becoming Bombay's new center.*

brutality to settle petty scores and playing various roles at the same time—surrogate parent, slum elder, disciplinarian, as well as dour detective. He is a good man but not bothered particularly by morals—he has slept with all kinds of women, and doesn't think too deeply about the wads of cash he shares with his colleagues and superiors, treating corruption as part of life.

His *bête noire* is Ganesh Gaitonde, a ruthless criminal who forms his gang through amorality and betrayal, raising his profile and becoming, over the years, one of the most dreaded gang lords in the city. Without his approval, land cannot be bought or sold, films cannot be produced and elections cannot be won. The duel between Mr. Gaitonde and the city's compromised police force, personified by Mr. Singh, is the core of the novel.

The novel traces Mr. Gaitonde's rise from petty criminal to major underworld don, using force amorally, getting people murdered, and yet becoming superstitious and god-fearing in the process. His rise, in a sense, mirrors the decline of political morality in Bombay, where unelected dons like Mr. Gaitonde hold sway over millions of people, using their *taporis* (gang-members) to settle scores against other *bhais* (dons). Mr. Chandra provides an entertaining mix of the phrases the cricket-loving thugs employ and shows us their fascination with starlets, as well as their symbiotic relationships where the starlets sleep with the thugs to secure minor roles in TV serials. He also uses Bombay's colloquial English—"putting down" phones, for example—but the language curiously never soars above the gravitational pull of reality, and does not display Rushdie-like pyrotechnics. That it is over 900 pages and remains a page-turner in spite of that,

demonstrates Chandra's mastery over the subject and his entertaining style.

One might get a sense of *deja vu* here: A year ago New York-based Suketu Mehta came out with a big, fat nonfiction work about Bombay, *Maximum City* (reviewed in the REVIEW in December 2004), which focuses precisely on the same terrain that Mr. Chandra's novel uncovers: violence, criminals, Bollywood, bar girls, slums, Hindu nationalist politicians, antinational Muslims, and poor people who surrender to the attraction of "Bambai-nagri" (Bombay city, as it is called in Hindi). Furthermore, around the same time a now-reformed Australian fugitive who did time in a Bombay jail, Gregory David Roberts, published a novel based on his experiences, *Shantaram*, which became an international best seller and covers similar ground.

Unlike Mr. Mehta's work, which was marketed as nonfiction, Mr. Chandra's work is firmly fictional, even though anyone who followed the city's politics and history in the 1990s will be able to see through many thinly disguised characters, who are drawn from exactly the kind of people Mr. Mehta encountered.

Those who have a nostalgic view of Bombay or who have formed their image of Bombay from the works of Mr. Rushdie may feel extremely uncomfortable navigating Mr. Chandra's prose. The language is coarse here, and the blood warmer and more real. You can smell the stench of slums and you laugh at the amorality of the god-fearing, cricket-loving, superstitious criminals. You get irritated by the petty corruption of the police force, but you also laugh at them. The Bombay Mr. Chandra describes is street smart and savvy, combining two attitudes *khadoos* (stubborn) and *bindas* (daredevil), and money

is the great equalizer and determiner of social relationships. Mr. Rushdie's Bombay is different: it is more fantastic, and he uses brilliant metaphors to create a larger-than-life impression of the city. Mr. Rushdie's Bombay makes us want to visit it with wide eyes; Mr. Chandra's Bombay makes us feel there are parts of the city best avoided.

What's interesting is that Mr. Rushdie writes about the city with its southern part as its firm focus: the high-rise buildings of Cuffe Parade, the commercial center of Nariman Point, the solid buildings of Fort and Colaba, the cricket grounds by Marine Drive, the Hanging Gardens, the posh parts of Pedder Road and Breach Candy, all the way up to the Worli Sea Face. Beyond that lies Mumbai, which you see from your window as you go to the airport to leave the city. (And beyond the airport is no longer Mumbai, but India).

In Mr. Chandra's world, the city starts in the seedier parts of slums, beyond Worli, to the suburbs beyond Juhu and Vile Parle, where films are made, industries hum and slums proliferate. During the years Mr. Rushdie grew up in the city (1947 to the early 1960s) and the years I lived there (1960s to the late 1980s), people from Mumbai came to work in Bombay. If you lived in Bombay, you had no real reason to go to Mumbai except to catch a flight, or to visit the National Park in distant north.

But the 1990s changed that significantly, and Bombay's center of gravity shifted, with once-suburban Bandra becoming the hub, and vast colonies like Lokhandwala in Andheri becoming microcosms as important as Colaba. Mr. Rushdie would probably feel out of place there, and would have to stop and ask for directions. Mr. Chandra's characters live and breathe in that suburban sprawl and rarely venture south; they are at home in the periphery that is fast becoming the city's new center.

That transformation in itself is fascinating: If Bombay today resembles more closely the bleak view in Mr. Chandra's fiction than the more innocent view in Mr. Rushdie's early works, it is an accurate summary of the moral decline of the great city. Mr. Chandra's view is different from Mr. Rushdie's. It does not make it more accurate, but it reveals lives we would not encounter otherwise.

MAO'S LAST REVOLUTION

by Roderick MacFarquhar and

Michael Schoenhals

Belknap Press, 752 pages, \$35

Reviewed by NEIL J. DIAMANT

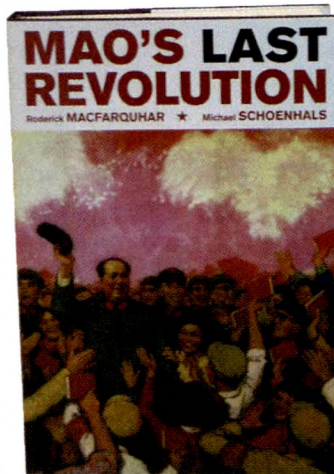
IT IS HARD to believe that it was only 30 years ago when the Cultural Revolution—not Shanghai real estate, Bank of China interest rates, or Beijing internet companies' initial public offerings—was the "hot" topic among anyone and everyone interested in China. In the heady atmosphere of the late 1960s, academics, journalists, politicians and Berkeley University revolutionaries all tried to make sense of the incomplete information coming out of China. Why were professors and veteran revolutionaries being pummeled by teenagers in "struggle sessions"? Why were people machine-gunning each other, running around with makeshift spears and knives? Why was the very notion of "profit" condemned and those who tried to make money attacked? Since that wrenching time, most China hands have moved on to more contemporary topics. Dissertations on the revolution are rare, investment bankers are the new

Mr. Diamant is an associate professor of Asian law and society at Dickinson College in Carlisle, Pennsylvania.

“The Chairman went as far as to suggest that the sign of the true revolutionary was precisely his intense desire to kill.”

sages and journalists have become more entranced with the country’s rapid current growth.

Thankfully, two of the West’s most prominent China scholars have not lost sight of the Cultural Revolution’s central importance, both in terms of its contemporary significance and its role in China’s longer historical trajectory. *Mao’s Last Revolution* is a landmark publication, not because it offers a new “theory” of what happened, or discredits others—the book is largely atheoretical by contemporary social science standards—but in the more traditional sense of great scholarship: It takes advantage of a treasure trove of newly available sources to give readers a more vivid, detailed and accurate picture of what happened between 1965 and 1976 than any other publication on the revolution to date. These new sources include personal diaries of Mao’s Red Guards; broadsheets; big character posters; minutes from politburo meetings; records of whispered comments between officers of the People’s Liberation Army; records of telephone calls between high-level leaders; and memoirs of rehabilitated officials and personal secretaries. Some of these records have been published; others were purchased in Chinese flea markets, of all places. (This is generally not covered in graduate courses on research methods.) The legwork, patience and perseverance alone in pursuit of these materials is probably worthy of an award or two.



What emerges is not particularly flattering to China: Heroes are few and far between, while villains of all sorts appear on practically every page. First among equals, of course, is Mao Zedong. The Cultural Revolution was his ill-conceived brainchild, which in the end turned Frankenstein-like on its master. Fearing “revisionism” in the communist bloc following

Khrushchev’s critique of Stalin, and “ideological backsliding” in his own party and society at large, Mao unleashed, sanctioned and glorified violence against those who did not share his vision. For Mao, widespread violence was good because it revitalized society and state, and necessary because it purified the Party of those taking “the capitalist road.” According

to Messrs. MacFarquhar and Schoenhals, Mao “had no scruples about the taking of human

life ... the Chairman went as far as to suggest that the sign of a true revolutionary was precisely his intense desire to kill.” Killing professors, enemies in the party, or people whose relations belonged to the “exploiting classes” was morally unproblematic, since a new society could only be built upon the destruction of the old. Even though there is scholarship suggesting that at least some of this violence was committed behind his back, this book makes it quite clear that Mao kept abreast of all important developments and approved all key decisions, from senior level purges to “arming the left,” resulting in the PLA supply of arms to Red Guards. Mao was mastermind and master puppeteer throughout.

But he was most assuredly not alone in his last, futile effort to turn back capitalism. Sycophants, ideologues, henchmen and “willing executioners” could be found everywhere, anytime. MacFarquhar and Schoenhals masterfully reveal the extent to which Mao was able to get his way, even though very few people seemed either to understand or agree with his ultimate goals. Unlike the disgruntled officers who attempted to assassinate Hitler in 1944, in China senior party and military officials—many of them veteran and accomplished revolutionaries—were incredibly lamb-like in the face of Mao’s bullying tactics, despite Mao’s reputation for poor policy-making. The role of Zhou Enlai is a good case in point. Suave, diplomatic and mild-mannered, the premier—often portrayed as the more human face of Chinese communism—very quickly fell in line, dispatching comrades he had known for 40 years and “with whose views on ... basic issues he was in total agreement” to prison. Many of these jailed revolutionaries eventually committed suicide in prison.

It is in the depth and extent of death, trauma and anarchy portrayed in this book that really leaves a mark. The numbers, culled from primary and some secondary sources, are simultaneously numbing and mind-boggling: More than 160,000 youth and children (mostly Red Guards) died as a result of an outbreak of cerebral-spinal meningitis, spread by Red Guards who traveled to revolutionary sites around the country; 1,772 people were murdered over a two-month period in Beijing during 1966; in the campaign to “cleanse the class ranks” between 1967 - 68, roughly 36 million people were persecuted; in the countryside, generations were buried alive (one little girl’s last words were, “Granny, I’m getting sand in my eyes!”—to which the grandmother responded, “Soon you won’t feel it anymore.”); in 1968 in Yunnan province, 6,979 people died from “enforced

suicide”; and in Guangxi and Yunnan provinces, some victims had their hearts, brains, livers, and testicles cut out and devoured by fellow villagers in the name of political revolution and class struggle. After the Cultural Revolution ended, few of the perpetrators of these crimes were brought to justice. How could they have been? Their actions were sanctioned by the very top ranks, explained away by the propagandists.

Widespread, uncontrolled violence—some Red Guard organizations designed and tested “primitive dirty bombs,” and teenagers were paid hard cash to kill—eventually led Mao to restore some control by sending Red Guards to cool their revolutionary heels in the countryside and calling in the PLA. However, when he realized that China was becoming a *de facto* military state—hardly what he anticipated at the outset of the revolution when he called upon the youth to rebel against authority—Mao began a new smear campaign against his Minister of Defense and heir apparent, Lin Biao, and rehabilitated senior civilian officials, such as Deng Xiaoping. Deng and Zhou, with Mao’s approval, restrained the radicals. The outbreak of hostilities with the U.S.S.R. in 1969 led Mao to seek a new accommodation with the “imperialist” United States—yet another unintended consequence of the revolution.

Messrs. MacFarquhar and Schoenhals provide us with fascinating details about how all of this came about—who said what to whom, and what the notes passed back and forth read—but never lose sense of the big picture. By reinstalling Deng and by failing to institutionalize the Cultural Revolution—let alone provide a convincing rationale for it—Mao opened up a very wide space for post-1978 economic reforms. After 10 years of state-inspired chaos, the post-Mao leadership was able to offer Western-style modernization (like Taiwan, Japan and South Korea) without

The new argonauts turn a potential brain drain into a "brain recirculation."

fear of a powerful, conservative, leftist backlash. This effectively ended the 100-year debate between Western modernizers and those who sought a distinctly Chinese method of development. As the authors sum up, "Mao's worst revisionist nightmare has been realized, with only himself to blame." True enough, but Mao's ghost still hovers over China. Its specter can be glimpsed in the numerous protests of laid-off workers who quote Maoist slogans when demanding more respect and money for basic necessities, as well as in the widespread nostalgia for Maoist campaigns in the countryside.

THE NEW ARGONAUTS: REGIONAL ADVANTAGE IN A GLOBAL ECONOMY

by AnnaLee Saxenian

Harvard University Press, 432 pages, \$27.95

Reviewed by MICHAEL SCOWN

THE ORIGINAL ARGONAUTS, Greek heroes of the ancient world including Heracles, Theseus and Orpheus, sailed with Jason in the *Argo* to recover the Golden Fleece, pursuing the Greek heroic ideal of "honor through action." In *The New Argonauts*, AnnaLee Saxenian, geographic economist and dean of the University of California at Berkeley's School of Information, argues that Asia's regional advantage in developing high-tech industries has largely been due to the efforts of a new generation of itinerant

heroes: graduate students who left their homes in Taiwan, India, China and elsewhere for the U.S. in search of advanced degrees and jobs with multinational tech companies. Having learned the game, they then returned home to open branches of U.S. companies, found their own ventures, or invest in other startups, turning a potential brain drain into what Ms. Saxenian calls a "brain recirculation."

The effects of this movement of knowledge and talent on the economic growth of the Pacific Rim, and the role that Silicon Valley has played as a training ground, market, and source of funding, is an important story and one that has not been adequately examined. Ms. Saxenian's book is thus valuable both as history, and as advice for governments trying to create the next technology cluster. It is a difficult story for an outsider to report, especially in Asia: Venture capital investing is a secretive world, where deals don't get disclosed except in dry securities filings. Despite that, Ms. Saxenian has largely gotten it right. This is a fascinating, if at times academic, history of how and why Asia's tech industry developed as it has.

While the argonauts metaphor is heroic, a more appropriate parallel might be found in the highly socialized and often unnoticed behavior of honeybees—insects that communicate with each other to signal the location of food, cooperate to build hives and create colonies in new locations—akin to the sharing of information and contacts that Ms. Saxenian's subjects practice to overcome discrimination and build the networks needed for success. Ease of information exchange and trust across ethnic professional networks have allowed entrepreneurs to rapidly source staff, get advice from successful role mod-

Mr. Scown is a managing director for Intel Capital Asia Pacific and is based in Hong Kong. The views presented here are his own.

els and draw on information they might not otherwise have had access to.

Ms. Saxenian argues that venture-backed enterprises have thrived in Asia in spite of—and not because of—government support. Despite all the technology parks, five-year plans and “laws to promote venture capital,” the spectacular growth of Asian tech companies mostly happened by accident. People trained in the U.S. pollinated new companies as they returned, bringing with them skills and knowledge. Serendipitous connections were solidified through formal and informal networks, alumni groups and industry associations that helped spread information and contacts. Networks and skills learned abroad helped bring Silicon Valley to Asia and fueled Asia’s technology development.

Transplanting Silicon Valley technology and management practices to Asia, Ms. Saxenian’s argonauts created “team-based corporate cultures with minimal hierarchy in environments that are dominated by family-run or state-owned enterprises.” But the new argonauts are not simply replicating the Valley in Asia—they can’t. The institutions that have made Silicon Valley what it is—efficient capital markets, well-defined intellectual property rights, functioning legal systems, well-funded education and research, and, above all, an absence of government interference—aren’t all present in any of these countries. The governments of Asia are thus perhaps wasting their time. Instead of building technology parks, they may be better off focusing on secondary education and sending top tertiary students overseas. Instead of trying to regulate venture capitalists, they would be better off providing the venture capitalists with a sound framework of company, securities, and bankruptcy laws, and then getting out of the way to let innovation grow.

This book argues for less government

intervention at both ends of the knowledge pipeline, demonstrating that the U.S. economy has also benefited greatly from the inflow of top foreign students who study in the U.S., work for American companies and then start businesses in the U.S. or elsewhere. These operations yield profits to American investors, supply components and services to American corporations, and spread a U.S.-centric model of business abroad.

Contrary to theories of technology development, this brain recirculation has led to a shift of both the manufacture and the development of technology from the core to the periphery. Technology is now being developed in Asia for incorporation into products designed in Silicon Valley. The countries that have benefited most are those that have invested heavily in higher education, such as Taiwan. Countries that haven’t have been left behind.

In a previous book, *Regional Advantage: Culture and Competition in Silicon Valley and Route 128*, Ms. Saxenian gave an excellent analysis of Silicon Valley’s rise to supremacy as America’s center of technology development. European leaders will find little cheer here as her new book argues that Silicon Valley’s lead is unlikely to dissipate, reinforced by the activities of the new argonauts. In effect, the pump has been primed and there is little, save for increased U.S. isolationism, that will shut off its flow.

The brain recirculation Ms. Saxenian describes may naturally slow as education and employment opportunities in the argonauts’ home countries improve. Already some Chinese and Indian students are electing to stay home because opportunities there may be better than what they would find abroad. Other factors could, however, impact this cycle in a less benign fashion. A major damper would be a further tightening of student and H-1B visa requirements in the U.S.: Scrutiny of

"We should be able to produce human beings under a quota system, just as we produce bicycles and tons of steel."

these programs was inevitable (and warranted) in the post-Sept. 11 world, but the U.S. should be careful not to choke this invaluable flow of talent. Finally, the failure of Asian governments to capitalize upon the catalyst provided by the argonauts—for example by neglecting to develop appropriate infrastructure in India—could limit their success.

Asia's technology growth cannot be reduced to mere cost advantages: It has also been driven by the movement of people, ideas and money to and from Silicon Valley. The enduring success of Silicon Valley, initially selected for its cheap land and proximity to Stanford and Berkeley Universities' deep pools of engineering talent, shows that advantages can persist well after such cost savings disappear.

CHINA'S LONGEST CAMPAIGN: BIRTH PLANNING IN THE PEOPLE'S REPUBLIC, 1949-2005

by Tyrene White

Cornell University Press, 296 pages,
\$39.95

Reviewed by STEVEN W. MOSHER

MY INTRODUCTION TO Chinese-style birth planning came in the spring of 1979, when I became the first American social scientist allowed to do research in China since the founding of the People's Republic of China. Getting permission had not been easy. My proposal to spend a year in a commune in Guangdong had caught the eye of the U.S. Committee on Scholarly Communication with China, but had been summarily vetoed by the Chinese side. Nervous officials at the

Ministry of Education and the Ministry of Foreign Affairs were not about to consent to an inquisitive foreigner roaming freely about the countryside.

They were overruled by no less a figure than Deng Xiaoping himself at a summit meeting with then-President Jimmy Carter. Pressed by Carter to approve my research plans, China's leader swept away all difficulties with a phrase. "*Meiyou wenti*," he reportedly said, "No problem." From that time forward, national, provincial and local officials obediently fell all over themselves to facilitate my research. They even allowed me to witness atrocities—forced abortions and sterilizations—that they themselves had ordered in the name of birth planning.

One day as I went about my research, a local commune official came to me with news of a new effort to control births. The provincial government, he told me, responding to pressure from the central government, had secretly ordered a one percent cap on population growth for the year. He and other local officials were complying the only way they could—by launching a birth control campaign to terminate as many pregnancies as possible. Several hundred young women who lived in the commune, all pregnant with their second or third children, were ordered to attend birth planning meetings. I went with them.

These young women were told that the rules governing childbearing had changed: No woman was to be allowed to bear a second child within four years of

~ Mr. Mosher is the president of the Population Research Institute and author of several books, including *A Mother's Ordeal: One Woman's Fight Against China's One-Child Policy* (Perennial, 1993).

her first, and third children were strictly forbidden. Furthermore, all women who had borne three or more children by November 1, 1979, were to be sterilized.

As I watched, increasingly horrified, I witnessed these young women harangued and threatened by senior Party officials. I followed them as they were taken, for the most part unwillingly and under escort, to the commune clinic. There I watched—with the permission of local officials who were eager to demonstrate their birth control prowess to a “friend of China”—as they were aborted and sterilized. I spoke with anguished husbands and heartbroken grandparents, and of course with these wounded women themselves, about their plight. I left China a few months later with their pleas for help echoing in my years.

I have always attributed these abuses directly to my “patron,” Deng Xiaoping. For in 1979, in a blunt-spoken speech to senior Party officials, he reportedly ordered them to “control China’s population growth. Use whatever means you must. Just do it. With the support of the Central Committee you have nothing to fear.”

Tyrene White, in her masterful new book, begs to differ. She argues convincingly that the die was cast decades before, when the newly triumphant Chinese Communist Party determined to govern the economic life of the country through a process of central planning. “As China moved to create a comprehensive planning apparatus in the 1950s,” she writes, “population control was included in principle as a part of that process.” The ideological justification for controlling the number of births was thus in place early, and of course was in harmony with classic Leninist doctrine of tight social, political and economic controls.

“Socialism should make it possible to regulate the reproduction of human beings. We should be able to produce human beings under a quota system, just as

we produce bicycles and tons of steel,” declared Vice Premier Chen Muhua in 1979. But she was saying nothing new. That the state should control reproduction had been the commonly held view of the Chinese leadership for almost two decades.

Why did the Chinese state not impose birth controls earlier? Primarily because of false hopes of rapid economic progress raised by the Great Leap Forward, Ms. White says. It was the disaster that followed the Great Leap Forward, when tens of millions starved to death, that convinced many in the leadership, most importantly Chairman Mao, that it was time to bring childbearing into the state plan and restrict the number of babies the Chinese people were allowed to bear.

Implementation was once again delayed though, this time by the chaos of the Cultural Revolution. It wasn’t until the early 1970s that China’s central planners inserted birth planning targets into a five-year plan for the first time. Up until the late seventies, these targets were primarily achieved by “encouraging” women with three children to undergo sterilization.

Deng Xiaoping was not satisfied with the pace of progress, however. Ironically, as Ms. White details, this advocate of modernization and economic reform ordered Chinese officials to undertake a classic Mao-era mobilization campaign to drive down the birth rate. He also, inadvertently, allowed me into the countryside to witness it.

By the time I left China in 1980 coerced abortions and sterilizations were the order of the day. The one-child policy, imposed piecemeal from 1979 onward, was in place nationwide by 1981. The policy remains in place in urban areas today, but has been relaxed in the countryside, however, where a de facto two-child policy has been standard since the mid-1980s.

So it is that China’s long campaign, as Ms. White calls it, still continues today. At times China is gripped by extraordinary

Here is a world where everything is for sale; and the commodification of information is particularly problematic.

campaigns—"high tides" in Chinese parlance—and reports occasionally seep out of China about massive numbers of sterilizations performed under a quota system and forced abortions undertaken en masse. At other times the campaign plods along, monitoring the reproductive cycles of women by the millions and inducing abortions and sterilizations on a case by case basis where necessary to stay within local targets. Chinese women continue to pay what Ms. White calls the "terrible price of China's attempt to engineer a fertility transition on the state's timetable."

Despite her criticism of the one-child policy, Ms. White nonetheless endorses the view that China does have "a population problem." This strikes me as odd, especially in view of her sophisticated understanding of the origins of the birth control program in Mao's failure to develop China.

The implications of that fact seem obvious: If the Chinese people had been allowed to develop China under a government that encouraged, rather than punished, entrepreneurial activity, that country today might well have a GDP larger than that of the United States. The Chinese people, in their numbers, would then be considered that country's principal asset, rather than its chief liability.

Many countries of the developed world—such as Japan, Taiwan, and much of Western Europe—are more densely populated than China in terms of population per square kilometer. However, none of these countries has declared war on its own people the way China has. Quite the opposite. Many of these countries suffer from labor shortages, and their governments encourage births and import foreign workers.

China's lingering backwardness stems not from its so-called population problem,

but from the mistakes made by its self-appointed rulers, from Mao Zedong onwards. How convenient for the Party to have a trendy foreign theory—overpopulation—that allows the Party leadership to blame the reproductive habits of the Chinese people for problems that it itself has caused. And how sad that Ms. White, who understands better than anyone the suffering the one-child policy has caused the Chinese people, should fall for it.

THE BANQUET BUG

by Geling Yan

Hyperion East, 288 pages, \$24.95

Reviewed by LESLIE HOOK

DAN DONG, A young peasant from Gansu province with "the face of a golden retriever," moves to Beijing with his wife and ends up making a living by pretending to be a free-lance journalist, even though he is barely literate. The dysfunctional life of the capital unfolds through Dan's eyes: the drunken rants of an aging artist; the family life of a prostitute; extravagant banquets; construction workers rioting to recover unpaid wages; and the wide-eyed amazement of his own wife, Little Plum, who enjoys walking around the city to see all the cars.

The premise—country bumpkin comes to the big city—is as old as they come, but Ms. Yan's novel has an original take. She zooms in on the netherworld of corrupt

Ms. Hook is a recent graduate of Princeton University and a Princeton in Asia fellow at the REVIEW.

journalism that draws in Dan. Initially he and his colleagues are paid simply to attend banquets and press conferences whose hosts hope for more publicity. But the rot soon spreads. Money changes hands to get stories run, or not run.

The trend of corruption among journalists and newspapers that Ms. Yan explores is a hot topic in China today. Since the concept of professional ethics is often ridiculed, reporters feel little compunction in putting press coverage, like everything else, up for sale as a commodity.

As the novel progresses Dan faces increasingly complex ethical dilemmas, the most difficult of which emerge not from officials who try to bribe him, but from the helpless souls of Beijing's underbelly who appeal to Dan for help. The last pages of the book offer a summary of what Dan learns: He "didn't realize how difficult it would be to get out a piece of truth in this country."

The banquets themselves, described in mouthwatering detail, are the set pieces around which the novel revolves. The desire to consume is a driving force for many of the characters Dan meets. And not just food. Prostitution is universal, not only in the strict sense of women selling their bodies. The novel makes explicit a whole range of deeds done for money that compromise personal values. Throughout the novel the characters sell things that shouldn't be sold, whether artwork, friendship or journalistic integrity. Here is a society where money is the only common value and almost everyone is a whore.

Not surprisingly, then, the most content person in *The Banquet Bug* is Dan Dong's wife, Little Plum. She is perpetually en-

tranced by the wonders of the city, asking Dan to take her to car parks, construction sites and freeway overpasses for fun on the weekends. She is too simple to ever question whether her life in Beijing is actually better than what she left behind.

The Banquet Bug is the first novel written directly in English by Ms. Yan, one of the better known contemporary female writers of the Chinese diaspora. She is perhaps best known as the screenwriter for the movie "Xiu Xiu: The Sent-Down Girl," a tragedy about a girl who is sent to live in the countryside during the

Cultural Revolution. Many of her previous works, like *The Lost Daughter of Happiness*, which is about a Chinese prostitute in America in the 19th century, have also been about places and times that are distant.

However *The Banquet Bug* is firmly rooted in Beijing, and so it is remarkable that Ms.

Yan chooses English to tackle a subject much closer

to home. She uses her non-native language skillfully, although the characters' English names ("Steel Bai", "Ocean Chen") seem to compromise the book's authenticity. There is the occasional awkward sentence, but this is outweighed by many original turns of phrase: "her dark red lips bloomed into a vicious smile"; or, describing a fake interview: "Dan holds the dead microphone, into which the master blows bitter chuckles from time to time."

Ms. Yan says that she feels more "straightforward" when she is writing in English, so it is significant that she has chosen English to write this critical portrait of life in Beijing, joining the growing ranks of Chinese writers living abroad who have turned away from their native language as their weapon of choice.



There are also details of their sex life that underline that, besides being a politician, Sun was also a womaizer.

**LOVE AND REVOLUTION:
A NOVEL ABOUT SONG QINGLING AND
SUN YAT-SEN**

by Ping Lu, Translated by Nancy Du
Columbia University Press, 192 pages,
\$24.50

Reviewed by JONATHAN MIRSKY

ACCORDING TO MS. Lu's introduction, this novel is to "have the appeal of fiction, where imagination colors in the blanks left by history, while remaining true to the facts." *Love and Revolution* is the story of Sun's last year of life, 1924-1925, and the entire life of his wife of only ten years, who died in 1981. A Taiwan-based novelist, Ms. Lu tells us she spent seven or eight years writing this book, shut away in her study where she "scoured the sea of documents" she had collected in the U.S., and digested the knowledge she had gained in China, Hong Kong, Japan and Moscow. Her book, banned in China and "definitely politically incorrect" in Taiwan, eventually appeared in a Japanese version and now at last in English.

The chapters alternate between the thoughts of the dying Sun in Peking Union Medical College in Peking, and the musings of his wife while under house arrest, together with a bit of narrative about her by one of her two "daughters." This person, whose identity is baffling through the first half of the novel, is really the child of "S," a handsome soldier presented to Madame Song as her personal assistant in her old age, whom she hopelessly fancies as he massages her ageing body.

If you are new to Sun Yatsen and his young wife, you will probably flounder about in the swirl of events and people. If, on the other hand, you already know the

Sun-Song story, the avalanche of names and events will not detain you, although Ms. Lu glides back and forth between different versions of the same history. She even includes the judgments of well-known biographers like C. Martin Wilbur, with whose sympathetic view of the frustrated, insufficiently tough Sun she aligns herself. The facts are there, too, for the Song story, which includes snatches about the American journalist Edgar Snow (Song facilitated his introduction to Mao at his guerrilla headquarters); the Party's flack Rewi Alley (though Ms. Lu is wrong to imply that anything bad happened to the supple Alley during the Cultural Revolution); and Song's death-bed apotheosis into the Communist Party.

But what about "the imagination"? The main thoughts of both Sun and Song concentrate on topics like, was it worth it? Where did we go wrong? Was so-and-so a friend or a traitor? There are also details of their sex life that underline that besides being a politician and 'Father of His Country', Sun was a womanizer before he met the pretty, much younger Song. This suggests too that Song had post-Sun lovers, although this is never explicit. There has been speculation that she wanted to marry "S," in her old age, but Zhou Enlai said no. Besides sex, Song remembers in lurid detail that Sun picked his nose.

The book is translated by Nancy Du, who is a university lecturer on translation and interpretation studies in Taiwan. Here is an example of her work. Song did not "realize the kind of crap he [Sun] had to take, in the name of these dreams."

Good historical novels are rare, though. I'm afraid that in *Love and Revolution* neither Sun nor Song comes across as anything except puzzled, guilty, or melancholy. ■

A MODEL SHANXI VINEYARD

by Hugo Restall

LIANG BAIJI SCUTTLES down a long row of barrels to extract another sample of Cabernet Sauvignon for his visitor. The juice came from the same plot, but is aging in a Hungarian rather than a French oak barrel, the winemaker explains. "Which do you like better?" Later he draws samples from two tanks of Chardonnay and ponders how to blend them.

By lunch time it's becoming difficult to keep it all straight, even after spitting out most of the wine. A chemist by training, Mr. Liang is clearly passionate about his adopted profession. As is everyone else at Grace Vineyard, perhaps because they are all new to the wine business, and because they are attempting something unique.

For we are in Shanxi province, a place that is synonymous in most people's minds with coal mines, heavy industry and pollution. The bulk of China's wine comes from coastal Shandong province, where, conventional wisdom has it, the soil and climate are best suited for viniculture. And bulk is the right word, because the Great Wall and Dynasty brand wines that originate there are famously undrinkable. So what hope does Grace have of producing a world-class vintage?

Judy Leissner, the CEO of Grace and daughter of its founder and chairman, C.K. Chan, admits to some trepidation at first. In the boardroom of the family company in Hong Kong's North Point, she describes how they spent two years looking for the

right place. "The scary thing is that everyone is in Shandong.... Even today, I meet winery owners who tell me, 'You made a big mistake.'"

But the gamble seems to be paying off. Grace planted in 1997 and had its first harvest in 2001. And already, it is the only Chinese wine on the menu at several top hotels and restaurants in the region, including Jean Georges Shanghai, chef Jean George Vongerichten's showcase on the Bund.

The 2002 reserves are shockingly delicious for such a young winery, especially the Merlot and Cabernet Franc. The Cabernet Sauvignon is solid but less interesting, and Pinot Noir didn't turn out well at all. Shiraz and several other varietals are going in, and a reserve Chardonnay is planned for this year. The winery also produces a small amount of Riesling and Chenin Blanc.

The potential for improvement is definitely there. The style started out resolutely Old World and is continuing in that direction, even though the new chief winemaker is an Australian, Ken Murchison. He visits Shanxi four times a year, spending more than three months there around harvest time. Grace is still experimenting to get the right varieties and techniques to suit the *terroir*, but Mr. Liang and his team are gradually taking on more and more responsibility.

Creating a great winery from scratch is always an uphill struggle, but never more so than in China. Start with the fact that Chinese don't really like to drink the stuff. Many view alcohol as one of the unpleasant chores associated with work, since the object of banquets is to get drunk in order to build rapport with partners. And anyway, Western wine is a sour brew that

∞ Mr. Restall is the editor of the REVIEW.

In a strange nod to the socialist past, Grace Vineyard has become a model farm, but with capitalists in charge.

takes a lot of getting used to.

Ms. Leissner describes how they tried to educate the farmers by having them taste the wine made from a plot of land tended properly, and then the wine from a plot where the farmer failed to follow the proper procedures. The farmers' first reaction was amazement that anyone would want to drink either of them, and they actually preferred the inferior wine because it had a weaker flavor.

Nevertheless, forging the way in Shanxi has its advantages. The climate is dry, and there are no other vineyards around, meaning there is less of a problem with diseases. The pollution here is actually not so noticeable, as the Tai-gu Plateau 40 kilometers south of the capital Taiyuan is primarily agricultural, growing apples and dates. It's also better to be far away from the big wineries in Shandong that have tarnished the image of Chinese wine—there are fewer bad ideas to overcome among the farmers and staff.

That's important because Grace is definitely not a big commercial operation—capacity is four million bottles, but current production is about half a million. Ms. Leissner and her father are dreamers, trying to create a truly great wine, and profit is of little concern. Although she says the winery is already making a bit of money, they went into the enterprise prepared to take losses for 25 years: "That's something that, when you tell people, it sounds ridiculous.

But our vision is not producing wine. Our vision is producing the best wine."

Other family investments in China, which range from water treatment to real estate, focus on returns. Grace is a legacy. Ms. Leissner compares it to the beautiful merchants' mansions that are now a tourist attraction in Shanxi. "Even if you are super rich today, if you don't leave anything that is valuable to others, nobody will remember you."

That motivation for founding a vineyard might be common, even a bit clichéd now in the West. But in China, most businesspeople are still in the phase of looking for quick returns, what Ms. Leissner calls a "gambler mentality." Building for the long term and cultivating an appreciation for things of beauty is not yet the norm.

However, Grace is definitely appreciated

by the local governments in Shanxi.

Perhaps even too much. At the winery, a group of township officials stops by, already a little inebriated, and they loudly consume several bottles. A large brass plaque with a hammer and sickle on the outside of the main building proclaims the presence of a Communist Party branch.

In a strange nod to the socialist past, Grace has become a model agricultural enterprise. Thus the government brings in busloads of officials to look and learn, much as they used to make pilgrimages in the communist era to another Shanxi model farm, Dazhai. This time the capitalist



roaders are in charge, but it's still a headache managing so many visitors, especially when they start scooping up bag-fulls of the river stones lining the pathways.

The official attention is a burden for a young business that is not really set up to accommodate so many visitors. But the Chans know how to navigate the official bureaucracy, as well as win the trust of the local farmers. In fact, Mr. Chan went to college in Shanxi after spending the Cultural Revolution as a shepherd in Inner Mongolia. Then the family was allowed to emigrate as they were originally Chinese-Indonesian. Once in Hong Kong, they first started out in trading and then began investing in the mainland after the reform era began.

So relations with the locals contracted to sell their grapes to the winery seem to be tolerably smooth, although it is time-consuming and labor-intensive work convincing the farmers to restrict their yields. The Grace viniculture team is out in the plots every day, visiting each one at least twice a week. The 400 farm households are paid a certain minimum price for the grapes plus a variable bonus that depends on a host of factors affect quality—especially whether they follow the experts' instructions. As a result, the farmers have clearly prospered, with most riding motorcycles rather than the bicycles that are the norm elsewhere.

After harvest, the grapes from each plot are tracked through the fermentation and aging process. That's how Mr. Liang is able to tell which barrels contain the wine from

certain areas. Such extreme attention to detail is allowing an accelerated process of trial and error.

The focus on building a brand in China means that only about 15% of the production is exported. The main base of distribution is in Shanxi itself for the table wines, and Grace is playing a part in the cultivation of a customer base among the new middle class, helping them to appreciate wine rather than just drink it to show off.

The need for education has clearly influenced the decision to set up a second operation, which will be in an area near Xi'an, not far from the site of the terracotta warriors. This time the focus will be on creating a New World style wine, and tourism will play a part, with a small hotel adjoining the winery. That is similar to the approach of the Bodega Langes winery in Hebei province, which runs a wine spa.

China's tariffs on imported wine are relatively low at 14%, Ms. Leissner says, so competition from abroad is intense. One challenge is training the staff at hotels and restaurants so they feel comfortable recommending a Chinese wine to customers who may assume that an import is necessarily superior.

Local and national pride in a good quality product may be responsible for the winery's early success. "Chinese don't want to be known for always making the cheapest stuff," Ms. Leissner explains. As a new ethos develops emphasizing quality over quantity, Grace is well positioned to emerge as China's most respected wine brand. ■

Can-Do Noodling

BEIJING RESTAURANTS HAVE to go to extraordinary lengths to attract customers. For instance, Hai Di Lao, a Sichuan hotpot joint, has its friendly staff ply customers



waiting for a table with free watermelon and cookies, plus free manicures for the ladies and shoe shines for the men. And if you order the *shuai mian*, or thrown noodles, a *shuai ge*, or handsome young man, will give you a noodle-stretching floor show.

Color-Coded Camo

WE'RE STARTING TO sympathize with the Chinese government's fear of color revolutions—they're tough on the business traveler's clothing budget. As a jet-setting friend complained, in order to blend in around the region these days, you need to coordinate your attire to the local political movement. Unfortunately, he got to Bangkok, where people are wearing yellow to show support for the king, and found that his wife, thinking he was going to Taiwan, had packed a red-themed wardrobe, the anti-Chen Shui-bian hue. In the Philippines, you're best off in white, the color of peace for those protesting against President Gloria Arroyo. Perhaps some enterprising soul in Shenzhen could start work on a line of reversible garments that would always provide us with appropriate political camouflage?

Rub, Rub, Rub

FREEBIE MAGAZINE Smart Travel Asia has put out a fun guide to making mischief in Tokyo. We were particularly attracted to the description of a bar in the entertainment district Roppongi: The Beatles-themed Cavern Club "hosts enthusiastic bands playing classics like 'All You Need Is Rub.'" Weirdly appropriate.

Death by Banquet

WE ALL KNOW how deadly Chinese banquets can be. After the endless courses of braised chicken feet, fried scorpions and sea slugs, it's time for toasting with throat-stripping sorghum liquor. Many is the time we thought we were going to die of some kind of poisoning, alcohol or otherwise. Now finally comes word that the authorities are apportioning blame on those who foist vile concoctions on their guests. The Chinese media report that after one poor sod really did die from banquet toasting, his family sued the hosts and won 35,192 yuan. Although we eventually recovered from our ordeals, we will instruct our attorneys to look into the possibility of recovering damages for pain and suffering.

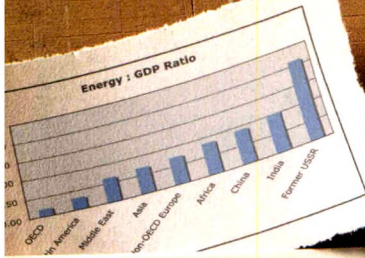
Race-Based Rip-Off

THE ASIA TRAVEL Web site advertises bargain rates at the Centrepont serviced apartments on Bangkok's Wireless Road—unless you happen to be from India or the Middle East. A prominent disclaimer in red type warns: These room rates are not applicable to Middle East & Indian Nationality.

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Mexico, and the entire UK.**

So what are we waiting for?

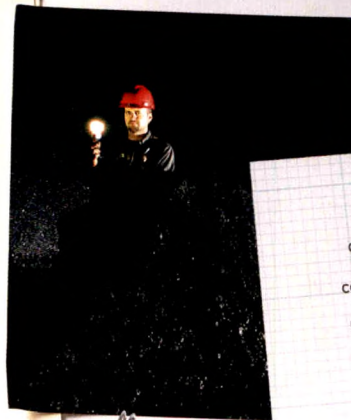


Because of surging economies in the developing world and continued growth among the industrialized nations, global energy use is climbing. As a result, supplies are tight. Prices are rising. And energy users are calling for viable alternatives.

The good news is we've got a huge source of alternative energy all around us. It's called conservation, and it's the lowest cost new source of energy we have at hand. A reduction of just 5% of global energy use would save us the equivalent of over 10 million barrels of oil a day. Clearly, saving energy is like finding it. So how do we do it?

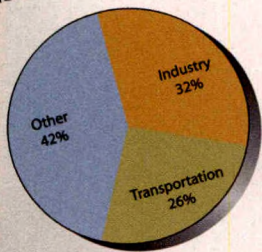
For developed and emerging economies alike, incorporating energy efficient technology into new construction could reduce consumption by 40%. Governments and businesses must reduce their own energy use and promote conservation to their citizens and employees. Further improvements in fuel efficiency will play a crucial role, too. And the average person wields incredible power when it comes to conserving energy, from driving slower to switching to more efficient home appliances.

Of course, not only does using less energy mean there's more fuel to go around, it also means fewer greenhouse gas emissions. The fact is, if everyone began conserving today, we'd see results immediately. We've taken some of the steps needed to get started but we need your help to get the rest of the way.

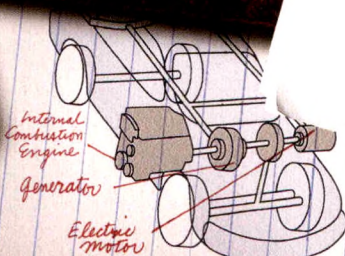


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FAR EASTERN ECONOMIC REVIEW

NOVEMBER 2006

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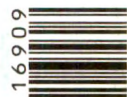
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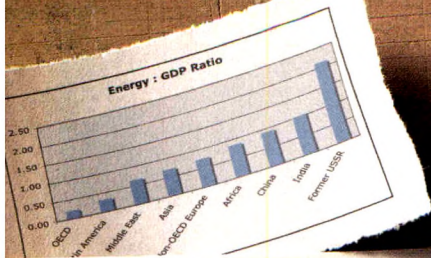
Jaime Zobel de Ayala
Craig Barrett
Stan Shih
Zhang Ruimin



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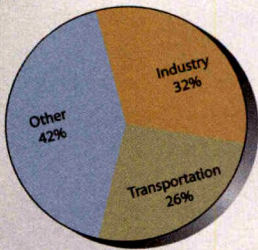
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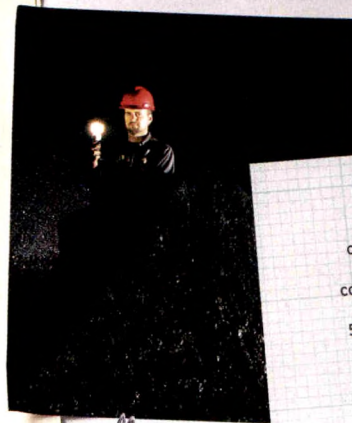
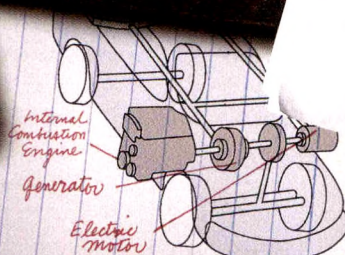
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Leslie Hook *Editorial Assistant*
Florence Lau *Administrative Assistant*

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[[THE WALL STREET JOURNAL BRIEFING]]

IN OCTOBER 1946, the REVIEW's founding Editor Eric Halpern penned his inaugural editor's note in a mood of optimism: "Given reasonably stable conditions for the future, a period of prosperity will certainly follow." He scarcely could have known how prescient that line would prove to be.

So what, you might say. From today's vantage point it seems East Asia's economic boom was preordained. Well, one has only to flip to pages 73-76 to get a different perspective. Hedda Morrison's photographs of Hong Kong taken right around the time Mr. Halpern made his prediction show how distant was the notion of prosperity for most residents. The region was just starting to recover from war; ideological struggle was already tearing China apart. The Korea War would shortly turn Asia into one of the principal battlegrounds of superpower conflict.

Over the past 60 years, the REVIEW has chronicled how Asians' entrepreneurial spirit created prosperity. New challenges to the march of prosperity are posited, such as environmental degradation and climate change. But given the progress of the last six decades, it surely won't raise many eyebrows if we predict that they too will be overcome.

So how to honor our predecessor's far-sightedness in this special anniversary issue? We decided to ask some of the most interesting people shaping Asia's future to share their predictions for the next decade. Leading figures in their respective fields, they represent diverse viewpoints. And they are all working to advance progress toward prosperity, security and well-being for Asia.

They too proved to be optimistic, but not just about economics. For the toughest predictions today are about whether Asia can overcome historical differences in the way that Europe did after World War II. China's thwarted dreams of democracy, the standoff on the 38th parallel in Korea, and tensions in the Taiwan Strait all have the potential to destroy much of the progress amassed to date.

As Eric Halpern was no doubt aware, the phrase "given reasonably stable conditions for the future" is a tremendously big assumption. The one thing that can undo the positive effects of human ingenuity is man's inability so far to build institutions reliably able to resolve conflict.

As Samuel Kim, Jared Genser and Colum Murphy write in this issue, some things haven't changed much: The threat from the Kim family regime in Korea still haunts the continent. But it's interesting to note that the financial markets are taking the supposed crisis in stride. They seem to agree with our contributors that optimism is justified.

H.R.

LETTERS

Get Out While You Can

I LEARNED WITH disappointment that the REVIEW has been banned in Singapore. I have read the “defaming” article which you wrote from your interview with Chee Soon Juan. I find that it is a well reasoned and well analyzed article that deserves to be published on the front page of the Straits Times, Singapore’s main newspaper.

I truly think that the reputation which the Lees (referring to Lee Kuan Yew and Lee Hsien Loong) have is not well deserved. It is earned by sweeping all dissenting voices under the carpet. Take away the carpet, and you could see horrors worse than hell.

Lee Kuan Yew is an elitist. His wife is a Queen’s Scholar. All of his three children are President’s Scholars. Only President’s Scholars can marry into the “royal” family. In the government sector, only scholars make up the top of the hierarchy. This is a frustration which many of us have when working in the government sector, where the scholars are given special attention.

After living in Singapore for the past 30 years, I have decided Singapore is not a place to live and raise my kids. I will be thinking of migrating in the near future. All the best for your defense in the lawsuit against the Lees.

Chia Mun Loong
Singapore

THE FAR EASTERN ECONOMIC REVIEW welcomes letters to the editor sent via fax to (852) 2503-1530, by email to letters@feer.com or by post to GPO Box 160, Hong Kong. Submissions must include the author’s full name, address and daytime contact numbers. The REVIEW reserves the right to edit letters for length and clarity.

A Chinese Advantage

AS A SINGAPOREAN I would like to express my support for your publication in its defense of the lawsuit brought by the Lees. My reaction was to come to your Web site to sign up for a subscription.

Although I fully support your cause and am aggrieved at the lack of free speech in my country, I also feel that the exercise of free speech is a responsibility that cannot be compromised by inaccurate reporting. Granted your pending dispute with the Singapore government, fairness in criticism is necessary for your magazine to retain its credibility and integrity against the accusations that have been made.

Thus, I would like to clarify the facts presented by Michael D. Barr in his analysis, and question if his criticism of bias in Singapore is not colored by a plank in the eye. Mr. Barr claims that in the early 1980s, the Ministry of Education favored SAP schools when allocating graduate English teachers and granted two O-level bonus points exclusively to SAP school students when they applied to enter junior college. “By contrast,” he writes, “neither Indians nor Malays received any special help, let alone schools of their own to address their special needs.”

This is blatantly untrue and reeks of polemical exaggeration. The bonus points are not granted exclusively to SAP school students, but are awarded to students from any institution who have excelled in Higher Chinese, Higher Malay or Higher Tamil. In addition, contrary to what Mr. Barr implies, the SAP schools do not represent the highest echelons of academic stratification: The Raffles schools, commonly regarded as the most prestigious schools, are

not SAP schools, and Malay and Indian students receive instruction in their respective mother tongues.

Another way in which Mr. Barr unfairly plays up the failures of the Singaporean system is by attributing to it "tremendous biases against women, the poor and non-Chinese." Such "tremendous biases" against women do not exist, if taken in relation to many other countries. I am female and never in my life have I felt the need to work harder than my male counterparts for the same achievement. If there exists a gender bias, it is certainly not reinforced by the "system" so much as a traditional mindset that happens to be even more pronounced in other Asian countries such as China, Malaysia and India.

Lastly, Mr. Barr writes that "if Singapore's meritocracy is truly a level playing field, as the Lees assert, then the Chinese must be much smarter and harder working than the minority Indians and Malays." In other words, the assumption that Chinese are *not* smarter and harder working than the minority races proves that Singapore's meritocracy is not a level playing field. What a simplistic assumption! Look at the Chinese after communism, as compared to the Russians. What race is successful in economic spheres despite being on the disadvantaged end of affirmative action policies in Malaysia and marginalized in the U.S.?

I believe that Chinese values just happen to be more materially oriented than other traditions in general; there exists a cultural basis for the disproportionate success of Chinese entrepreneurship. On the other hand, the vast majority of Malays are Muslim; the naturally larger size of Muslim families means that parents have less time and resources to devote to each child's education. I would think that the reasons for the relative success of the Chinese people are social, not political, and cannot be so lightly dismissed. Mr.

Barr comes from a country with a no more distinguished track record on racism, and therefore should be fair to Singapore.

Esther Fang
Ann Arbor, Michigan

The Suffocated Country

THANK YOU SO much for all the insightful and truthful reports about Singapore. You do not know how much those articles mean to the islanders as we try to survive in an oppressive and suffocating country, and live with the injustices and betrayals the old despot and his precious spawn have committed against us. They are selling out whatever trust the locals have placed in them. And the media, who should be the guardians of the Lees' land, have let us down and are now a mere mouthpiece of the you-know-who.

Henry Chai
Singapore

Better Reception Wanted

I'VE BEEN A reader of the REVIEW (on and off) for the past 20 years here in Singapore. I congratulate the REVIEW for taking a stand and making the articles on Singapore freely accessible.

The PAP government has done a great job in putting Singapore on the world map in the socioeconomic sphere. But it should be more receptive to alternative and critical views. The REVIEW is such an avenue. I deeply appreciate the articles, now, in the past and in the future as well.

Steven Yeong
Singapore

Nuanced Views of the King

ONE WOULD HARDLY know from Grant Evans' September review of my book, *The King Never Smiles: A Biography of Thailand's King Bhumibol Adulyadej*, that it

highlights the political philosophy behind the Thai monarchy's support for military coups against elected governments over the past six decades. Nor did Mr. Evans reveal that another main theme is how King Bhumibol mastered and adapted traditional ritual to restore power to the throne and build an overwhelming popularity among the Thai people.

Both themes, of course, are germane to the September coup against Prime Minister Thaksin Shinawatra. The palace's implicit support for the coup would make any assessment of King Bhumibol's political life and thought useful, whether one agrees with the conclusions or not. Mr. Evans, though, ignores my book's core theses to instead condemn me as simply a hater of monarchy, traditional Asian culture and King Bhumibol himself.

To reach such malicious conclusions, Mr. Evans distorts and even fabricates the book's content. For instance, he brands my coverage of the shooting death of the previous king, Ananda Mahidol, Bhumibol's elder brother, as "jaundiced," even though I have said little new from what has been in print for years.

And he strongly suggests I assert that Bhumibol himself killed Ananda because he "coveted the throne." There is nothing in the book to support this borderline libelous statement. I have no idea whether Ananda shot himself or was killed by Bhumibol, the two possibilities most accepted among historians. If the latter, I clearly term it an accident that occurred in play.

Mr. Evans says Ananda's death was used by former Prime Minister Phibun Songkhram to tar "leftists," like former Prime Minister Pridi Banomyong. Yet my book makes meticulously clear that it was the royalists, the palace's highest princes and their backers, who campaigned to

smear Pridi with Ananda's death. This point is crucial to understanding King Bhumibol's restoration of royal power, but again Mr. Evans misrepresents the book.

While he offers other such distortions, more astounding is Mr. Evans's attempt to suggest I dismiss the ritual, visual symbols and other traditions which shore up Bhumibol's image as a saintly Buddhist king. Mr. Evans calls me galled and puzzled by such rituals: "That these rituals strike a deep chord across Thai society is clearly beyond Mr. Handley's imagination."

That's funny, because so much of my book, including most of the first chapter, details the centrality of traditional rituals and symbols in Bhumibol's restoration. Indeed, I titled the book *The King Never Smiles* to emphasize this, explaining very early on that the king's conscious avoidance of smiling, and the lack of him doing so in almost all official portraiture, is to project himself as an impeccable *bodhisattva*. But Mr. Evans, who as an anthropologist should get the importance of ritual imagery in modern politics, calls the title "supercilious," saying I really want King Bhumibol to "go around glad-handing people with smiles plastered on [his] face in the manner of U.S. politicians."

If I sum up Mr. Evans' assessment of my book, it is the mindless work of a Western-fixated, unqualified and insensitive mere reporter who scorns Thai culture and people, hates monarchies, and depends mostly on unsourced gossip to fashion an ugly picture of a monarch that he doesn't realize is genuinely loved by the Thai people. This is strikingly similar to the Thai palace and government's official view of my book, designed to convince people to dismiss it without reading it.

Paul Handley
Washington, D.C.



The Mirage of A United Korea

by Samuel S. Kim



THE DEMOCRATIC PEOPLE'S Republic of Korea is back in the news and high on the agenda of the United Nations Security Council as East Asia's most active flash point. Pyongyang's announcement that it conducted a nuclear test on Oct. 9 prompted the Security Council to adopt unanimously a U.S.-sponsored sanctions resolution against North Korea. U.N. Security Council Resolution 1718 was the first-ever sanctions resolution based on a nuclear test that was unverified, and the first sanctions resolution China and Russia ever supported. No doubt many pundits will seize upon Resolution 1718 as telegraphing the collapse of North Korea and Korean unification by absorption.

Perhaps at no time since the end of World War II, when Korea was liberated and divided, has the prospect of Korean unification seemed closer, yet never has it been more distant. The prospects of Korean unification, shot through with ironies and contradictions, are far more problematic than abiding post-Cold War wisdom would suggest. On the one hand, it is the weaker

North Korea—far more than the stronger South Korea—that holds the key to shaping the future of the divided peninsula. On the other hand, the future, if any, of North Korea itself depends largely on the support of outside powers, most importantly South Korea, China, the U.S., Japan and Russia, in that order. Consequently, the prospect of Korean reunification is a function of North Korea's system dynamics, a complex and ongoing interplay of domestic reforms and external support.

Predictions of Collapse

AS IF TO compensate for their failure to predict the rapid succession of momentous changes in the international system from 1989-91—the crumbling of the Berlin Wall, German reunification, the end of the Cold War, and the demise of the Soviet Union

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and international communism—many pundits in the early 1990s committed the opposite fallacy of making prematurely optimistic predictions about the collapse of the D.P.R.K. and the unification of the Korean peninsula. This resulted in a wave of euphoria that had a divided Korea heading inexorably toward German-style unification. Then, in the wake of the sudden death of North Korean President Kim Il Sung in July 1994, came a second wave of predictions: North Korea would either collapse within six months or experience a German-style unification by absorption within three years. Even South Korea's then president, Kim Young Sam (1993–98), embraced this “collapsist” view, seeing North Korea as a “broken airplane” headed for a crash landing.

A third commotion about unification, primarily within the peninsula, surrounded the historic inter-Korean summit of June 13–15, 2000. Despite the official claim in the North that these events were “the greatest successes in the reunification movement since the country was divided into two parts,” a great paradox surfaced when then President Kim Dae Jung and Chairman Kim Jong Il embraced each other before global television audiences, symbolically signaling their acceptance of each other's legitimacy. Even more remarkably, the front page of the June 15, 2000, issue of Rodong Sinmun, the official organ of the Korean Workers' Party, showcased the South Korean leader to the domestic audience for the first time as “Republic of Korea President Kim Dae Jung” and as a cosigner of the North–South Joint Declaration. The summit seemed to have brought the two Koreas to a stance of peaceful coexistence as two sovereign states, with a peace that was *de facto* if not fully *de jure*.

While Pyongyang paid mandatory lip service to the supreme task of building “one nation, one state with two governments and two systems” under the “feder-

ation system,” in the wake of the summit it proclaimed publicly for the first time in Rodong Sinmun that “the issue of unifying the differing systems in the North and the South as one that may be left to posterity to settle slowly in the future.” Throughout the months before and after the summit, then President Kim Dae Jung repeated his now familiar line that he did not expect Korean reunification to take place on his watch, or even in his lifetime. And the fact that inter-Korean trade more than quadrupled to \$1.58 billion in 2005 from \$371 million in 1999 in the face of the second U.S.-D.P.R.K. nuclear confrontation testifies to the growth and depth of inter-Korean relations.

The Absorption Fallacy

DESPITE THE HYPE about an impending collapse, the future of North Korea is far from certain. The collapse-and-absorption argument, which draws from German-style unification by absorption, has been marred by freewheeling conceptualization, right-leaning bias, and inattention to evidence of the many obstacles and barriers to peaceful Korean unification. It has never been clear exactly what would collapse: Would it be the economy, the regime, the system or the state? Collapsist arguments commit the fallacy of premature economic reductionism based on the misleading equation of economic breakdown with system or state collapse. North Korea's resilience since the mid-1990s and the regime's control over its citizens, in fact, speak against an economic collapse that would cause a regime, system, or state collapse.

For collapse and absorption to work successfully together, four basic conditions would have to be met. First, the D.P.R.K. would have to collapse because of its economic difficulties and without triggering another Korean war. But North Korea would certainly not collapse without a

The idea that Korea is a homogenous nation awaiting unification is ethnocentric romanticism.

big fight or without generating a huge mess that no neighboring power would be willing or able to clean up.

Second, the North Korean Army would have to agree to lay down its arms and abandon or surrender any nuclear command and control system already in place. The various collapse scenarios often overlook the issue of how to deal with North Korea's one-million-strong army. The peaceful accommodation or demobilization of the military in the North into a unified Korea would pose a problem of unprecedented magnitude, and this alone provides North Korea with unparalleled leverage to exercise its "collapse card."

Third, South Korea would have to find the resources to politically, economically, socially and culturally absorb the land and people of the D.P.R.K.

Finally, a reunified Korea would have to give up its nuclear holdings and demonstrate that it would be a force for stability in Northeast Asia. Central to the collapse-and-absorption argument is the popular assumption that unification is the necessary and sufficient condition for securing a long peace on the Korean peninsula. Despite the primordial passions fueling so many internal wars in trouble spots in the post-Cold War world, there is nothing intrinsically empowering or enduring about national unity, especially if it is a hegemonic unity. Seoul, like Pyongyang, is hardly eager for a North Korean collapse, as evidenced in the pursuit of the "Sunshine Policy" (1998-2002) and the "Policy of Peace and Prosperity" (2003-present).

Domestic, inter-Korean and Northeast Asian factors transmitted from the past are such that after more than half a century of fratricidal politics, the two Koreas have developed different nations, states, systems,

societies, cultures and identities. The notion of one homogeneous but divided nation-state waiting to be unified upon the removal of external sources of conflict is simply ethnocentric romanticism that is cherished and exploited by hypernationalists in both Koreas. There is little doubt that the North Korean leadership is determined to use all available instruments of national military power, including weapons of mass destruction, to avert absorption by the South. Even without going nuclear, North Korea commands "the tyranny of proximity," and massive and forward-based forces deployed aggressively along the northern side of the peninsula's so-called demilitarized zone. Moreover, North Korea is believed to have the world's third-largest inventory of chemical weapons, as well as an impressive array of delivery systems. In this respect, Pyongyang's nuclear card serves not only as a cost-effective strategic equalizer but also as a cost-effective insurance policy for regime maintenance.

In the unlikely event that a system collapse were to occur, it would probably be violent and bloody, triggering internal civil violence rather than peaceful unification. Fearing the social, economic, political and military costs of German-style unification, Seoul would probably prefer to intervene to set up a separate regime or build a "Berlin Wall" to defuse the refugee "bomb" that would otherwise explode in the nation's capital. Even before the advent of South Korea's financial crisis in 1997, a fundamental change in public perception of the costs and benefits of unification had already taken place.

As South Koreans have learned about the North's massive famine and about the international expectations for Korean unification by absorption, they have become

increasingly worried that their own lives would change for the worse and increasingly outspoken against unification by absorption. More and more South Koreans expect their government to prefer some kind of division between North and South even after unification, until the economic level of the North is raised.

The politics of fragmentation and regional antagonism in the South remain active despite the remarkable transition to democracy in 1987. Since the founding of the Republic of Korea in 1948 there have been 12 declarations of martial law and emergency decrees, and several thousand industrial strikes. To add a collapsing North Korea and a southward flood of several million poverty-stricken refugees seems a sure recipe for another fratricidal civil war, or even the end of Korean democracy.

To quicken Korean unification by absorption would be to conflate and magnify the worst elements in two societies with separate systems and diverging identities beyond the carrying capacity of a "united" Korea. Even under the most optimistic scenario—a peaceful reunification without much bloodletting—a united Korea would most likely become hypernationalistic, posing a serious regional security challenge with the potential for extreme disruption.

A Costly Reunification

COLLAPSE SCENARIOS FOR North Korea typically revolve around the country's economic woes. Suffering from the same systemic problems that have plagued most socialist state-run economies, North Korea's economic health has deteriorated further because of interruption or reduction of foreign trade, famine, allocation of resources to the military, and the use of scarce resources for grandiose projects glorifying the Kim family state. It is estimated that the monetary cost of rescuing a collapsing North Korean economy would be between

\$250 billion and \$3.5 trillion, although such figures are little more than shots in the dark given the absence of reliable statistics on North Korea and the uncertainties regarding domestic and external factors. Indeed, the focus of research and debate in South Korea on unification has shifted subtly but significantly from the question of how to achieve it, to more sobering and rational cost-benefit calculations.

The closest comparison case is reunified Germany, where unification euphoria in West Germany quickly degenerated into despair and recrimination as West German subsidies bound for East Germany ballooned to \$100 billion annually, while East Germany experienced an unprecedented rise in unemployment, social alienation, and rates of death and suicide. In 1998 then Chancellor Helmut Kohl, the reunifier of Germany, was voted out of office—his singular achievement had become one of the causes of his electoral defeat. German one-nation identity proved to be a slender reed rather than a solid foundation for national reconstruction.

South Korea is no West Germany, North Korea is no East Germany, and the German precedent—where no fratricidal war had occurred—is not the perfect analogue for the Korean peninsula. The Iron Curtain in Germany was far more permeable than the 38th parallel is today: East Germans tuned into West German radio and television, and beginning in the 1970s, between 1.1 million and 1.6 million East Germans visited the West each year, with 1.2 million to 3.1 million West Germans traveled in the opposite direction. South Korean President Roh Moo Hyun was clear: "Korea's unification process will be fairly different from Germany's." Perhaps the most desirable and feasible lesson to be drawn from the German experience is the model of "one Germany, two states" that was in effect from 1972 to 1989.

The social impact of potential North

The sheltered and uninformed Northerners would be relegated to second-class citizens.

Korean collapse and/or unification is even more difficult to calculate than the economic impact. Although much is made of the ethnic homogeneity among North and South Koreans, the truth is that the degree of similarity is difficult to assess. After 61 years behind a Stalinist curtain of nearly absolute control, how similar are North Koreans to their brethren in the South?

Whereas South Koreans are cosmopolitan and technologically adept, North Koreans are sheltered and uninformed. As has happened to East Germans, North Koreans likely would be relegated to a second-class status in a unified Korea, and the two to three million members of the military and the *nomenklatura* would need to be retrained and deideologized. Recognizing the differences that have developed between North and South Koreans, 78.5% of South Koreans polled in a 1995 survey by the Sejong Institute in Seoul advocated unification only after the recovery of "national homogeneity," and only 9.5% favored immediate reunification. Such evidence suggests that despite the strong emotional appeal of unification, enthusiasm quickly wanes when the costs are considered.

One of the most symbolic manifestations of diverging Northern and Southern identities is the extreme difficulty that most North Korean defectors encounter in the South, despite being offered generous financial aid, job training and other assistance. Whereas only 607 North Koreans defected to South Korea before 1989, by September 2004 about 6,300 North Koreans had defected. North Korean defectors have had trouble dealing with the competitive nature of a market society, handling money, and making wise choices among competing goods, according to several scholarly studies. They have found their

North Korean education insufficient given the need in South Korea for computer skills, grasp of English and knowledge of Chinese written characters. These experiences set a poor precedent for any future integration.

It is particularly revealing that defectors from the North suffer from psychological problems far more than do immigrant workers from other countries. Many defectors criticize South Korean society and its people for being "closed" and "selfish." Defectors from the North unanimously agree that the vast majority of North Koreans harbor great love and respect for Kim Il Sung as the man who freed them from the Japanese, defeated the Americans in the Korean War and built the foundations of the national economy.

These differences in identity between North and South Korea are not without precedent in Germany. East Germany's first freely elected prime minister, Lothar de Mazière, once said, "Every day we are surprised anew that 45 years of separation had a greater impact upon us than we thought it had when the Wall came down." This may be even more relevant for the two Koreas than the two Germanys.

A Functional Approach

A SCENARIO OF unification by consensus would require that the two Koreas, especially the stronger South, take a series of practical steps toward the creation of a "working peace system" in the mode of historian and political theorist David Mittrany's functionalism. The question of how long the post-Kim Il Sung system will survive and in what shape or form has no simple answer. A functional approach to the peace process, while committed to demo-

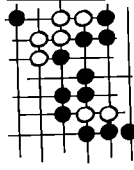
cratic and peaceful unification as the ultimate end, proceeds from the following premises: First, national unification per se does not automatically bring about peace, power, prosperity and democracy; Second, Korean unification without a prior working peace system may be a sure recipe for catastrophe; And third, the two Koreas must first initiate the politics of regional reconciliation with changes at home and then start the functional peace process by discussing areas of mutual interest on which they can most readily reach agreement. Herein lies the logic of the Kaesong Industrial Complex and Kungang Tourism projects as *de facto* unification, or unification defined as the ongoing peace and reconciliation process, and also the logic of Seoul's resistance to Washington's pressures to terminate both projects in compliance with America's interpretation of Security Council Resolution 1718.

The working peace system is premised on the acceptance of identity differences and the notion that all social and economic actors in both Koreas will come together based on what unites them. This functional

approach, starting in the area of economics, could provide the popular pressure necessary to keep inter-Korean dialogue alive, while stimulating the opening of more channels of communication and exchanges in related areas. This is what is meant by the "peace by pieces" approach: Pieces that can be seen as constituting organic elements of gradual social and economic integration of the two Koreas lead gradually to a working peace system.

Ultimately, this approach is not limited to actions on the Korean peninsula. It will also involve the active participation of the Big Four (China, the U.S., Japan and Russia). While the participation of the U.N. in resolving the conflict on the Korean peninsula has been limited so far, there may be an increasing role for international organizations and international NGOs to play.

In the final analysis the unification drive of the two Koreas resembles a Taoist paradox: Doing less and less is really achieving more and more. To hold together different parts of a whole, one must first let them go their separate ways. ■



Stop Pyongyang's Autogenocide

by Jared Genser



SINCE NORTH KOREA'S nuclear weapons test on Oct. 9, 2006, the international community has focused on urging the country to refrain from taking further provocative acts while also trying to manage the global implications of the test. There has been little media coverage about the terrible suffering of the North Korean people. Nevertheless, it is critical to remember that the situation in North Korea is also one of the most serious human-rights and humanitarian disasters in the world today.

Since its founding, North Korea's communist leaders Kim Il Sung and Kim Jong Il have implemented a policy of *juche*, or self-reliance. As a result, North Korea intentionally isolated itself. It was only after the famine in the mid-1990s, in which at least one million people are thought to have died, that tens of thousands of refugees streamed out of the country in search of food. With these refugees came reports of the horrors of life in North Korea—about the government's failure to feed its own people and a widespread system of political prison camps. Up to that point, many main-

stream human-rights groups, which would ordinarily issue human-rights reports only after visiting a country, had refrained from reporting on North Korea because they were unable to access the country.

It has, therefore, only been in the last five to 10 years that NGOs have been formed to focus on the situation in North Korea. At the outset, this burgeoning grassroots movement was fractured because the dialogue about how to address these concerns covered the political spectrum. On the left, many groups, including a number in South Korea, argued that raising human-rights and humanitarian concerns would drive North Korea from the nuclear talks, create greater tension on the Korean Peninsula and ultimately make unification of the two Koreas more difficult.

This perspective underpinned South Korea's official attitude, embodied in the "Sunshine Policy" first adopted in 1998.

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A South Korean boy looks at photos of starving North Korean children. Over 37% of North Korean children are malnourished.

And a number of other governments around the world also embraced a softly, softly approach. Those on the right—including a number of Christian evangelical groups—publicly advocated regime change, believing that such a hard-line position was the only moral solution to the situation and could ultimately yield the kind of change required in North Korea.

At the same time, there was also substantial debate within the movement about the efficacy of providing humanitarian aid to the North Korean people. While such aid clearly saves lives if administered within internationally recognized guidelines, the North Korean regime has tended to reduce its food purchases by the amount of aid received and then divert resources to its military and nuclear programs. Whether such aid should continue has long been a point of contention.

More recently, however, progress has been made to narrow the gap in views about the best way to proceed. The largest catalyst to that end has been the now more than 7,600 North Korean defectors living in Seoul who have told their stories of suffering and oppression under Kim Jong Il's regime. As a result, both left and right have slowly been moving toward a pragmatic center. Many on the left have now recognized that the problems in North Korea are enormous and the international community has some obligation to try to ameliorate

the suffering. And many on the right have acknowledged that a drumbeat for regime change, while a strong and unequivocal moral statement, is not an actionable approach in the international community and at the United Nations in particular. While divisions persist, there is a critical mass of advocates who are now prepared to place progress above ideology.

It is in this context that former President Václav Havel of the Czech Republic, former Prime Minister Kjell Magne Bondevik of Norway, and Nobel Peace Prize Laureate Elie Wiesel commissioned the writing of a major report on the human rights and humanitarian situation in North Korea. As articulated by these leaders, it was their intent to broaden international understanding, build support among groups across the political spectrum, and ultimately seek to break the logjam on engagement with North Korea.

Kim Jong Il's recent test of a nuclear weapon presents the international community with a unique opportunity to reassess its entire approach toward North Korea. For those who had argued for years that suppressing criticism on human-rights grounds would keep North Korea engaged in the nuclear talks and implicitly increase the chances for a deal, North Korea's detonation of a nuclear device has been a bitter wake-up call. In that one action, Mr. Kim demonstrated that the international community's compromises on human rights did not affect his behavior on security issues.

This moment could not have come at a more opportune time. The U.N. Security Council recently adopted the doctrine—previously endorsed by the General Assembly at the World Summit in New York in 2005—that each state has a “responsibility to protect” its own citizens from the most egregious human-rights abuses. While under the U.N. Charter states retain sovereignty to control their own territory, if they fail to protect their own citizens

from severe human-rights abuses, the international community now has an obligation to intervene through regional bodies and the U.N., up to and including the Security Council. The formal adoption of this doctrine was a historic and unprecedented action by the community of nations to acknowledge what had already been understood for many years—that the world should not use state sovereignty as an excuse to turn a blind eye to the most serious suffering and oppression.

The crux of the Havel-Bondevik-Wiesel report is that the North Korean government is actively committing crimes against humanity against its own people, that U.N. engagement to date on these issues has been unable to yield either symbolic or concrete results, and therefore it is time to launch a parallel track effort in the U.N. Security Council to ease the suffering of the North Korean people.

In the case of North Korea, two sets of actions qualify as crimes against humanity. With respect to food policy and famine, North Korea allowed as many as one million—and possibly many more—of its own people to die during the famine in the 1990s. This was caused, in part, by the North Korean government's choosing to reduce food purchases as international assistance increased so it could divert resources to its military and nuclear program. Hunger and starvation remain a persistent problem today with over 37% of North Korean children chronically malnourished. Malnutrition not only stunts physical growth, but also causes countless mental defects and learning disabilities among North Korean children.

Despite this, the North Korean government has requested less food assistance from the World Food Programme and continues to deny access for transparent distribution of food to 42 of its 203 counties. At the same time, the government has also criminalized many of the coping mecha-

nisms used by North Koreans. If you are a starving North Korean, you can neither forage for food in a neighboring county because of the limitation on the right to free movement, nor purchase food from a private market. As a result of cuts in food aid, WFP has indicated millions of North Koreans will face "real hardship" this winter.

The situation with food policy and famine constitutes both extermination (which includes in its definition under international law the creation of conditions of life leading to great suffering and death) as well as other inhumane acts. These actions are systematic, widespread and directed at a civilian population. Although many of these acts appear to be intentional, there is no need to prove this point. Under customary international law, there is a presumption of knowledge if acts are themselves systematic or widespread. Acts of this nature do not happen in a systematic or widespread way by accident, and knowledge can therefore be inferred.

Furthermore, the North Korean government's operation of its gulag system constitutes crimes against humanity. North Korea imprisons as many as 200,000 people in its political prisons. Not only are real or imagined dissenters imprisoned without due process of law, but so are their family members, including the elderly and children, under a guilt-by-association system instituted by North Korea's founder Kim Il Sung. Prisoners in the gulag are provided starvation-level rations, forced to work long days under brutal conditions, and many face torture or execution for trivial offenses. It is estimated more than 400,000 have died in the North Korean gulag over 30 years.

Attempts by the international community to engage with North Korea on human-rights and humanitarian concerns have come up short. Resolutions adopted by the U.N. General Assembly and former Commission on Human Rights have been reject-

ed by North Korean representatives and ignored. North Korea also refuses to recognize the mandate of the U.N. Special Rapporteur on Human Rights in North Korea, Vitit Muntarbhorn, and has denied his numerous requests for access to the country. Having already sanctioned North Korea, the Security Council must now reinvigorate its efforts to help the suffering people of the country. As a first step, the report recommends that the U.N. Security Council adopt a nonpunitive resolution urging open access to North Korea for humanitarian relief, release of political prisoners, access for the U.N. Special Rapporteur and ongoing engagement by the U.N.

Some skeptics have suggested that this approach is doomed to failure. They argue that not only will North Korea be unwilling to engage with the international community, but that historic allies of the country on the Security Council, such as China and Russia, will block any action in the Security Council. It is true that China in particular has very legitimate concerns about the stability of the situation in North Korea and needs to watch its step. For example, if the North Korean government was to collapse or the country was to have another famine, tens of thousands of North Koreans could stream into China looking for food, much as happened during the 1990s famine. This would have a serious destabilizing effect on the region.

Given the consequences of a humanitarian crisis, it would be in China's national interest to take steps that seek to stabilize the precarious situation in North Korea, whether or not North Korea wants to see these steps taken. Even more importantly, China has more leverage than any other country to persuade the North Korean government to cooperate. If the Security Council were to try and engage with North Korea by adopting a resolution of the kind recommended in the Havel-Bond-*evik-Wiesel* report, it would be possible,

for example, to urge North Korea to provide open access for humanitarian assistance. While North Korea would likely balk at such a request from the Security Council, China, Russia, and other members of the Council would be in a position to urge North Korea to comply. Nothing could be more in China's self-interest than to ensure that the people in North Korea are fed, especially those who happen to live close to Chinese border.

So why would China want to act now? Simply put, it is running out of time. Given the ominous warning signs, unless the world acts quickly, there could be a torrent of refugees fleeing into China in search of food across China and North Korea's 880-mile border within several months. More importantly, increasing assistance under the auspices of a Security Council engagement process could direct that food aid be provided through WFP, not like the unconditional aid that has historically been provided by China and Russia. Such an approach would give the requisite transparency and accountability to ensure that the neediest people are being fed and that resources are not being diverted to feed the military or other elites.

It is only if the contemplated engagement process fails that the Havel-Bond-*evik-Wiesel* report recommends moving to the adoption of a binding resolution under Chapter VII of the U.N. Such a resolution is binding under international law and would also carry the implicit threat of sanctions. Nevertheless, the report intentionally does not call for, encourage or take a position on sanctions because its focus is on merely trying to spark an engagement process with North Korea.

Regardless of whether China will reach the same conclusion about the need for stability along its border, the world cannot sit idly by while so many people are suffering. Whatever happens, we owe it to the people of North Korea to try. ■



Testing Japan's Pacifist Resolve

by Colum Murphy

CALL IT THE mushroom cloud with a silver lining. Just a few weeks after Shinzo Abe took over as Japan's prime minister, North Korean leader Kim Jong Il decided it was time to test a nuclear bomb. In so doing, he gave the new Abe administration the perfect opportunity to pick up the pace for Japan to become a "normal" nation, including molding the Japan Self-Defense Forces into an army capable of defending Japan and its sole military ally, the U.S, in the event of a military attack. Currently, the SDF are forbidden to use force outside of Japan, according to Article Nine of the Japanese Constitution which stipulates:

Aspiring sincerely to an international peace based on justice and order, the Japanese people forever renounce war as a sovereign right of the nation and the threat or use of force as means of settling international disputes.... [L]and, sea, and air forces, as well as other war potential, will never be maintained. The right of belligerency of the state will not be recognized.

This restriction effectively rules out international individual or collective self defense. In other words, Japan cannot use force outside of Japanese territory to defend itself (individual self-defense) or come to the rescue of its ally (collective self-defense).

Yet, according to Article 51 of the United Nations Charter, all countries have "the inherent right of individual or collective self-defense." So how to explain the gap between what is considered an inherent right under international law, and the prohibition of that right under Japanese domestic law? The current formulation—as articulated by the Cabinet Legislation Bureau, the government body charged with interpreting Japanese law, among other responsibilities—is that while Japan may have that right, it does not or cannot exercise that right. (Theoretically, however, the bureau could be persuaded to expand the scope of operations for Japan's de facto armed forces by giving more weight to the U.N. charter.)

While this may seem rather academic, the implications are very real. Specifically

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with respect to the North Korean crisis, for example, Japan cannot use force when conducting maritime inspections outside Japanese waters. Pre-emptive strikes against North Korean missile bases could also be problematic—even if there were credible evidence of an imminent ballistic missile attack. The issue came up in July this year, just after the North Korean missile tests, when the Associated Press quoted then Chief Cabinet Secretary Abe as saying: “If we accept that there is no other option to prevent an attack ... there is the view that attacking the launch base of the guided missiles is within the constitutional right of self-defense. We need to deepen discussion.”

Furthermore, with regard to the issue of collective self-defense, if a U.S. vessel were attacked outside Japanese waters (and no Japanese vessel is attacked), then the SDF would not be able to come to the aid of the Americans. If such a scenario were ever to pan out, some analysts predict it would be extremely difficult to convince the American public that the U.S.-Japan alliance was really worth preserving. A Japan without the backing of the U.S. would be a very isolated and extremely vulnerable place indeed.

Not surprisingly, many in Japan consider the legal framework governing the country's security no longer appropriate. On Sept. 29, in his first policy speech, Mr. Abe told members of the lower and upper chambers of the Japanese Diet that in light of “changes in the international situation,” the government would “thoroughly study individual, specific cases to identify what kind of case falls under the exercise of the right

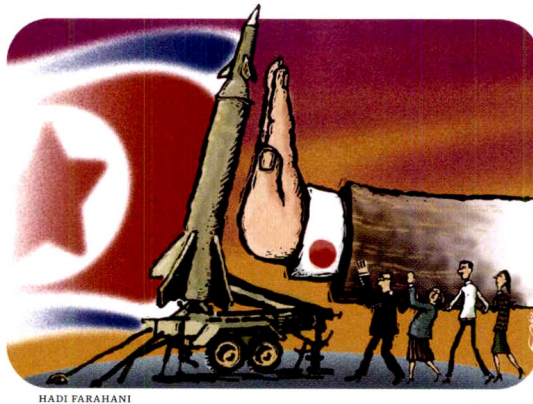
of collective self-defense which is forbidden under the constitution, so that the Japan-U.S. alliance functions more effectively and peace is maintained.” One week later, the “international situation” took a turn for the worse when the North conducted its nuclear test. While it is important not to overstate the direct impact of the nuclear test—the debate about Article Nine has been ongoing for years—it has brought a greater sense of urgency to the discussion.

Yet a consensus on how best to increase Japan's security is still a long way off. Even the more immediate issue of how to punish

Pyongyang in the wake of its test is proving divisive. On the one hand, conservatives such as Hisahiko Okazaki, a former diplomat and director of the Okazaki Institute in Tokyo, lauds Mr. Abe's handling of the crisis, commending what he sees as

the “exceptionally assertive role” the Japanese government has played in the wake of the test. Japan quickly imposed sanctions on the D.P.R.K., banning North Korean vessels from entering Japanese ports and imposing a total ban on North Korean imports. Tokyo also announced measures to step up law enforcement related to the D.P.R.K.'s alleged involvement in money laundering and drug trafficking, and expressed its willingness to cooperate with the U.S. and other countries in maritime inspections of North Korean ships.

Mr. Okazaki, who some analysts believe holds some sway with Mr. Abe on foreign-policy issues, says the time for dialogue has passed. “We need the carrot and the stick. But we used so much carrot in the past, and it didn't get us anywhere.



Kim Jong Il's nuclear test might be the catalyst for Japan to amend or reinterpret its constitution.

So this time we should use the stick," he says. Even if the North were to agree to suspend its nuclear program, it would be too little too late. "That's not acceptable anymore," he says. "It should be complete abolition [of its nuclear program]."

Tsuyoshi Yamaguchi of the Democratic Party of Japan (his business card bills him as Japan's "Next Minister of Foreign Affairs") does not agree. While he stresses Japan should not take a weak stance on the D.P.R.K., he is quick to caution that history warns against pushing countries to take extreme actions, citing Japan's own history prior to World War II. "Before Pearl Harbor, the Americans, including many in Congress, would say, 'We have to stand firm. The Japanese will back down,'" he says. But the Japanese did not give in. "We were in a kind of a corner, like a rat struggling with a big cat. We should not do the same thing to the North Koreans."

The ruling Liberal Democratic Party has been seriously considering how to handle the North Korean threat for some time—well before the October test and the July 2006 missile launches by North Korea. Its election manifesto for the Sept. 2005 lower house elections stated that normalization of relations with Pyongyang would not take place unless the two countries could first come to agreement on a host of issues, including a satisfactory explanation by Pyongyang as to what happened to the Japanese citizens (at least 13 people) that were kidnapped by the North and forced to serve the regime. More tellingly, for the first time ever the manifesto threatened economic sanctions against North Korea.

In May 2005, Ichita Yamamoto, an upper house member of parliament for the LDP and frequent commentator on foreign policy issues, warned in an interview with

the REVIEW that failure to stop the D.P.R.K. from going nuclear would have serious implications for Japan and "change the whole paradigm of security in East Asia." He further predicted that, "If we have a North Korea with a nuclear missile, and the nuclear missile is one which may attack Japan anytime, we will have to do something so that we can match the new threat from the bomb." This, he said, included giving serious consideration to strengthening the SDF, and to introducing Tomahawk and other missiles. Mr. Yamamoto even raised the specter of a nuclear Japan. "I am very much afraid that even the argument of arming Japan with nuclear weapons will arise," he said. Now, as per Mr. Yamamoto's predictions, serious discussion of more enduring ways to protect Japan—that go beyond reactive measures to punish Pyongyang—is gathering momentum.

Whether Japan might opt to go nuclear is a question often heard—particularly in foreign media. The Japanese government has vehemently denied that going nuclear is on the cards. Sugio Takahashi, a research fellow at the National Institute for Defense Studies (NIDS), a think tank attached to the Japan Defense Agency, concedes the number of people considering the nuclear option in Japan is increasing, but he says this does not mean that support for it is growing. Mr. Takahashi believes the October test in itself is not sufficient to drive Japan to reinterpret or amend its constitution. "The test is only one variable," he says. "The test makes reinterpretation or amendment of the constitution a little bit easier—but it's unpredictable."

Significantly altering Japan's pacifist constitution is going to take time. As Japanese journalist and occasional contributor to the REVIEW Kenta Tanimichi explains,

the first step is for Japan to pass a law that would allow a referendum on the issue. "Without this law, amendment is impossible even if both upper and lower houses of the Diet agree," he says. But getting agreement from the Diet will also be trying, since a two-thirds majority of a joint session of both houses would be required. "This may involve achieving a compromise with the LDP's current coalition partner, the Komeito [party] and the DPJ," he says. Komeito has expressed strong opposition to amending Article Nine.

The DPJ's Mr. Yamaguchi says that in principle he is "not allergic" to Japan's having the right to collective self-defense, but that in the present political context, it could prove dangerous. "Opinions have been swinging rather extremely to the right," he says. "In this context.... I am rather cautious about it." His party agrees that constitutional reform may be necessary—but not Article Nine. "It all comes down to Nine and the right to collective self-defense," he says, adding that his party still needs to come up with a common line on the issue.

This politically divided atmosphere effectively means that any move to amend the constitution is off the cards until at least after the July 2007 upper house elections. Even then there is no guarantee that the LDP could muster enough support. That is why many analysts expect meaningful change to the constitution to be at least another five years off. An alternative to formally amending the constitution would be for the Abe administration simply to "reinterpret" it as per last month's policy speech by Mr. Abe. Achieving this, says Mr. Okazaki, is much more straightforward, requiring the government only to declare a reinterpretation. Mr. Okazaki predicts that Mr. Abe will take steps toward this end "in the coming several months."

But Mr. Takahashi of NIDS doesn't foresee the Abe administration making a

sweeping reinterpretation of Article Nine anytime soon. Instead, he says, there may be some "minor reinterpretation" to allow, for example, Japan's Maritime Self Defense Forces to offer protection support to U.S. vessels in Japanese waters. (The Japanese government postponed, for now, a formal decision on the matter, Jiji press reported on Oct. 25.) The more tangible outcome of the North Korean nuclear tests, he believes, will be the earlier deployment of defensive weapons. For example, the Japanese government has decided to deploy Patriot Advanced Capability Three missiles by the end of fiscal year 2006, which ends in March 2007—several months ahead of the original schedule.

It could be that one of the most important results of Pyongyang's nuclear test is its impact on Japanese public opinion. Most Japanese seem to have taken the test in their stride—Mr. Takahashi describes the reaction from the public as "modest" and says there was more pronounced reaction to July's missile tests by the North Koreans. But, taking a longer-term view, journalist Mr. Tanimichi says that the attitude of the Japanese toward militarization has changed "quite dramatically." He elaborates, "If you look back to say 1990, few people thought Japan could send troops into a war zone," he says. "The Japanese government was forced to withdraw its offer to cooperate during the Gulf War. Then in 1992, the government met fierce opposition when it tried to pass the Peacekeeping Operations Law—and not just from leftists."

But things are very different now. A turning point, says Mr. Tanimichi, was in September 2002 when the North finally admitted its involvement in the abduction of Japanese. From then on, the Japanese public began to see North Korea as a "hostile nation." The October test marked another escalation in animosity—but this time the long-term repercussions for regional security are greater. ■



China's Low-Profit Growth Model

by Weijian Shan

THE UNITED NATIONS Population and Demographics Office reports that the average height of adult Chinese women has reached 170 centimeters, up from 159 centimeters in just about 25 years. On average, adult Chinese women are about four centimeters taller than American women.

According to an opinion poll conducted on a group of American, European and Asian professionals who either have lived in or have visited both China and America, 97% attribute the height growth to "better nutrition in the Chinese diet" or other factors such as the increase in interracial marriages as a result of China's open door policy. Only 3% of the polled suspect anything wrong with the data.

I apologize to the respondents that I, the pollster, made up the Chinese height statistics and the UNPDO does not exist. But I thank them for helping me confirm a hypothesis: People generally do not question statistics from what seem like authoritative sources, such as the UN, no matter how implausible the information is. Everyone who has visited both countries knows

that Chinese women are not taller on average than American women. And it is also impossible for half of the adult population of a nation of more than one billion people to grow its average height by as much as 11 centimeters in 25 years. This exercise proves, however, that something many very smart people believe is right can still be totally wrong.

Such is the case, as I have argued in these pages and elsewhere, with some of the major findings of the World Bank on what return on capital China produces, and on how Chinese firms finance their investments. At issue is not whether the profits of Chinese firms have grown, as the World Bank researchers suggest. No one disputes that. But a growing dwarf is still no giant. At issue is whether China allocates and uses capital efficiently enough so that it produces a return on capital at par or better than international markets. The question is: By international standards, how efficient is China in using its capital?

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My own analysis of the same data used by the World Bank concludes that the return-on-equity numbers reported by it are significantly overstated because they do not net out such items as corporate income taxes. The World Bank does not dispute this. But it insists that Chinese firms are now making so much profit that undistributed profits or retained earnings finance more than half of their investments, whereas bank loans finance only one-third or as little as one-sixth. If this is true, it suggests that Chinese firms finance their investments with much less debt in proportion to equity on average than probably all their international peers, and therefore by implication they must have been more profitable. For evidence, the World Bank points to the increase in the proportion of corporate savings in China's national savings, now accounting for more than 20% of GDP.

Some believe that Chinese corporate savings are overestimated and household savings underestimated. Nevertheless, assuming that these numbers are correct and that corporate savings do represent more than half of corporate investments (or whatever percentage the World Bank says, as it has used, rather loosely, different numbers in different contexts), does it mean that Chinese firms on average finance more than half of their investments with undistributed profits?

All Air Is Not Oxygen

THE WORLD BANK researchers tell us that corporate savings, as a macroeconomic concept, are equal to undistributed profits or retained earnings *by definition*. Unfortunately that definition is as correct as defining the air we breathe as pure oxygen. As a macroeconomic concept, corporate savings consist of more than just undistributed profits. In addition, corporate savings include depreciation, amortization (both of which are treated as costs in any corpo-

rate income statement) and other things (including government subsidies). Depreciation alone is a big number. China's growth is driven by fixed-asset investments which now represent more than 50% of GDP and still grow at 25% to 30% per year. As such, China's fixed-asset base expands each year and so the amount of depreciation from such an asset base also increases. Nobody knows for sure how big the depreciation number is because China's statistical authorities do not have complete data in this regard, but one can make some safe estimates.

The enterprise data series published by National Bureau of Statistics includes the net fixed-asset value of industrial firms of scale. By NBS estimates, depreciation represents about 12.5% of net fixed assets in 2003, up from 9.1% in 2000 and 2001 and 11.5% in 2002. Based on this number, depreciation is roughly 11% of net asset value for 2005. The net profit of these firms should be no more than 8% or 9% of net asset value in 2005. But for the sake of argument, let's use 9% and also assume there is no dividend payment (when in fact, many Chinese companies do pay dividends). By this calculation, depreciation alone (11% of net asset value) is more than 1.2 times as large as undistributed profits (9% of net asset value) or at least 55% of corporate savings. Undistributed profits at most represent about 45% of corporate savings.

Therefore, if corporate savings represent 60% of corporate investments, undistributed profits account for no more than 27%, *from a macroeconomic point of view*. How remarkable a percentage is that? Not very. Importantly, as long as China's fixed-asset investment continues to grow at the current rate, then depreciation, and therefore corporate savings, will grow accordingly, regardless of whether there are any undistributed profits.

Other sources of data which the World Bank researchers claim to have checked to

By having overlent and underpriced their risks, Chinese banks have in effect subsidized firms.

support their story of investments mostly financed by undistributed profits do not provide a different picture. For example, in enterprise survey data, "self-possessed" or "self-raised" funds both include substantially more than undistributed profits, such as depreciation, amortization and other items which no business calls undistributed profits.

Who Bears the Risk?

BUT THIS IS only the beginning of what the World Bank experts got wrong. Now we know that corporate savings are not equal to undistributed profits. But assuming corporate savings are mathematically equal to 60% of corporate investments, can we therefore conclude, as the World Bank does, that *corporate savings* finance 60% of China's corporate investments? The answer is still an emphatic no. In fact, there is absolutely no way anyone can draw any inference on how firms finance their investments in aggregate from corporate or national savings data. Even if the amount of corporate savings exceeds corporate investments, as in the United States, bank loans can still finance as much as 100% of corporate investments. The key to knowing who provides financing is to understand who bears the risk of providing money to enable investment.

A simple example will make this clear. Suppose there are only two firms, A and B, and one bank in a simple economy. Firm A, which has no debt, puts \$1,000 in savings into a bank and Firm B, which has no equity, borrows \$1,000 from the bank to make a \$1,000 investment. In this case, the World Bank will say corporate savings finance 100% of corporate investment from the viewpoint of macroeconomy. But what

happens if the investment is completely lost? Do corporate savings disappear? They do not. Ultimately, it is the bank, not Firm A, which has provided financing for Firm B, because every time the bank makes a loan, it puts its own capital at risk. If the loan is lost, the bank suffers the loss but is still obligated to pay back Firm A. The role of the bank is far from simple intermediation, such as the role played by a brokerage firm selling stocks for its client. The bank is a provider of risk capital. This ought to be obvious to anyone who has ever had a bank account.

What if the bank does not have adequate capital to cover the losses? In most cases depositors still get their money back, either through a government-sponsored deposit insurance scheme or, as in the case of China, a government bailout.

How do we know how much banks have financed corporate investments in China? There used to be no confusion before the World Bank came along. The data series on Chinese industrial firms provides information on the aggregate debt-to-equity ratio, which is the quotient of total amount of debt divided by total amount of net asset value. This ratio, at about 150%, has remained basically unchanged over the past five years, indicating that in aggregate, Chinese industrial firms, at least those in the NBS database, finance 60% of their investments with bank loans. Therefore, regardless of the fact that corporate savings are mathematically equal to 60% or 100% of corporate investments, bank loans still finance the majority of China's corporate investments.

The actual aggregate debt-to-equity ratio must be even higher. This is because a large amount of corporate debt has been converted into equity in the past few years

either through debt restructuring or after major banks removed their bad loans to government-owned asset management companies. The total value of such transfers is about \$432 billion, or approximately 18% of China's 2006 GDP, according to Moody's. The debt-to-equity ratio would certainly be significantly higher than reported if none of these bad loans had been converted into equity.

Those who argue that the aggregate debt-to-equity ratio has declined in the last 10 years are simply not familiar with China's history of the reforms of the state-owned sector. The debt-to-equity ratio at that time is not comparable with the current numbers, as it was around that time a massive amount of debt had been converted into equity through a nationwide "debt-to-equity conversion program." This happened long before the recent recapitalization of major Chinese banks. One of the companies I studied 10 years ago, Tianjin Seamless Steel Pipe, had about \$1 billion debt on its balance sheet but no equity (it was owned by the state which, at the time, treated most corporate funding as debt through an earlier "ownership to debt conversion program"). Through the nationwide "debt-to-equity conversion program," a large amount of debt was converted into equity, contributing to the sharp decline in debt-to-equity ratio at that time. This program was already history five years ago.

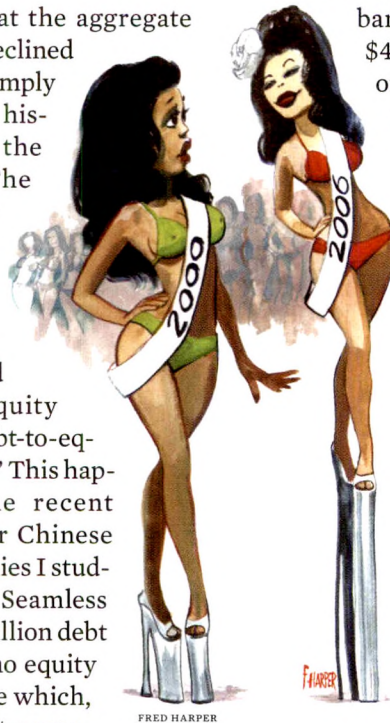
The reason that banks accumulate bad loans or suffer losses is because they overlend or underprice their risks. This allows the borrowing firms to overinvest or invest in projects which do not produce returns sufficient to cover their risks. Therefore,

the amount of bad loans in the banking system is the best indicator of inefficiencies in an economy. If on average, return on capital is sufficient to cover investment risks, there should not be a significant amount of bad loans. How much have Chinese banks overlent or mispriced their risks? Moody's estimates that it would require \$620 billion, which is equivalent to 25% of China's

2006 GDP, to recapitalize China's banking system, including the \$432 billion already carved out of the banks but still largely unfunded by the government. These numbers are largely based on official accounts. As such they are very conservative. Other independent estimates have put the capital required much higher. Regardless, to put this number into perspective, it is roughly equal to all pre-tax profits in the seven years from 1999-2005 of all the industrial firms in the NBS database combined!

The World Bank argues that Chinese banks' nonperforming loan ratio has fallen in recent years.

That is true. But to date, it is the government-sponsored removal of bad loans from major state-owned banks, the capital injection by the government which enabled banks to write off lost loans, and the increase of the asset base due to rapid loan expansion that have been entirely responsible for the decline in the bad loan ratio. There is no evidence that Chinese banks have begun to price their loans correctly. In fact to date there is hardly any differential pricing between banks. This year, the central bank has had to impose restrictions on banks from lending to 11 major industries which are deemed to have



suffered overcapacity or overheated. If banks adequately control or price their own risks, such restrictive measures would have been unnecessary. Therefore, nobody should be so naïve as to believe that Chinese banks have stopped lending to bad credits or that they are now pricing their risks correctly. If the central bank does not believe it, why should you?

By having overlent and underpriced their risks, Chinese banks have in effect substantially subsidized firms. The money required to recapitalize Chinese banks can be viewed as bank subsidies to firms without which the collective profitability of Chinese firms would have been much less—if there were any profits at all. Chinese women are taller now than 25 years ago because, at least to a large extent, they are wearing high heels. Chinese firms appear taller because they stand on Chinese banks.

At the Margin

THE WORLD BANK has made much of the fact that corporate profits have increased since the late 1990s. Indeed, NBS data show that, assuming a 30% effective corporate income-tax rate, net profits have increased at an annualized rate of 28% from 1998-2005. But one has to keep in mind that China's fixed-asset investment also has been increasing at about 25% to 30% per year during the same period. You would expect more profits on a \$5 million investment than a \$1 million one. Indeed the sheer number of firms in the database alone has increased to about 250,000 in 2005 from 150,000 in 1999. There is nothing surprising or remarkable about the amount of profits increasing in light of the massive investments and the number of new entries.

What about profit return on investment? The average return on equity for these firms has grown much more modestly. Assuming a 30% effective corporate

income-tax rate, ROE has grown at an annualized rate of 3.8% since 1999, and it did not increase between 2004 and 2005. In my September essay in the REVIEW, I attributed part of the increase to net productivity gains which have grown more than 5% per year during the same period of time. But that is not the full story. The picture is not complete without looking at the role of banks. To see where the profitability gain comes from, we need to go through some simple "margins analysis."

Businesses look at different margins to understand different aspects of operating performance. Gross margin is calculated by dividing the difference between sales revenue and costs of goods sold by sales revenue. It is used to gauge whether the movement in input and output prices is favorable or unfavorable for the business. Gross margin for the industrial firms in NBS database has fallen by 3.51% per year from 2000-05, indicating that these firms in general have been under severe pressure from either rising prices of raw materials or falling prices of finished products or both.

But net margin has been up modestly during the same period. Net margin is the ratio of net income divided by sales revenue. Assuming 30% effective corporate income-tax rate, net margin for these firms has increased by 0.49% per year. This indicates that in spite of the falling gross margin, these companies have been able to increase net income per unit of sales over this period.

What explains the gain in net margin in spite of falling gross margin? We can find out the answer by examining the "EBIT margin," which is the ratio of earnings before interest and taxes divided by sales revenue. This margin indicates how much a company has earned from a unit of sales before paying interests and taxes. EBIT margin has fallen by 0.47% per year during this period of time. A falling EBIT margin indi-

cates that companies have earned increasingly less before interest payments. Productivity gains obviously have not been sufficient to offset the decrease in gross margin. This is where banks, once again, come to the rescue. Clearly, interest rate cuts more than offset the decrease in EBIT margin, which is the only reason why the net margin increased.

By now, we know that average ROE for Chinese industrial firms is not high by international standards. We have also established that undistributed profits do not finance more than half of corporate investments. Neither do corporate savings. The increase in net margin for Chinese industrial firms in the past seven years comes entirely from interest rate cuts. Banks have played the rich uncle, rescuing and subsidizing Chinese firms with huge amounts.

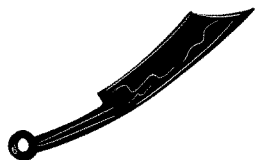
So are Chinese banks profitable on average in comparison with their international peers? Not at all. The past three years were the best ever for Chinese banks. Yet, their average net return on assets, at 0.4%, is the lowest in Asia. Even without taking into account the need for provisions for bad loans, they are still the least profitable among their Asian peers with their pre-tax, pre-provision profit return on asset of merely 1.1%. Search no further for China's elusive superb returns. They do not exist.

Low return on capital is the hallmark of the growth model driven largely by fixed-asset investments, such as China's. This issue was laid to rest years ago when a number of leading economists, notably Professors Lawrence Lau, Alwyn Young and Paul Krugman, presented conclusive evidence that the so-called Asian miracle was produced much more by greater

input than productivity gains. They were proved right beyond the shadow of a doubt by later events, particularly the 1997-98 Asian financial crisis. China is no exception, only worse. Its growth has been particularly costly, wasteful and inefficient, pockets of excellence notwithstanding.

There is no lack of examples of sustained high growth in the annals of world development history. However, no economy in the history of mankind has ever come even close to investing as much as China does today to produce a double digit growth. I am not a big fan of using incremental capital output ratios to measure the efficiency of capital allocation and use for an economy because capital is not the only factor contributing to economic growth. But at times the ratio provides a reality check. If it takes 25% of 2005 GDP to re-capitalize Chinese banks, adjusting for such losses would shave 3.1% off the GDP growth number each year for the past 10 years, reducing the average growth rate to only 6%, as opposed to 9.1% per year.

China has embarked on major banking reforms and meaningful progress has been made. But the economy's growth continues to be driven by excessive liquidity, and so is costly and inefficient. Improving profitability, returns and efficiency remains the highest priority. While China is on the right track in her search for a cure, the last thing she needs is someone in a doctor's white gown to come along to tell her she is in excellent health. Fortunately, the leadership knows better. The policy of the central bank to raise interest rates, mop up excess liquidity, curtail lending to overheated industries and generally increase the cost of capital is correct and necessary for sustained growth in the long term. ■



Forestalling Strategic Conflict in Asia

by *Brahma Chellaney*



A FUNDAMENTAL AND qualitative reordering of power in Asia is already challenging strategic stability and affecting equations between the continent's major powers. As they maneuver for strategic advantage, China, India and Japan are transforming relations between and among themselves in a way that portends closer strategic engagement between New Delhi and Tokyo, and sharper competition between China on one side, and Japan and India on the other.

Yet, given the fact that India and China point across the mighty Himalayas in very different geopolitical directions and that Japan and China are separated by sea, they need not pose a threat to each other. The interests of the three powers are becoming intertwined to the extent that the pursuit of unilateral solutions by any one of them will disturb the peaceful diplomatic environment on which their continued economic growth and security depend.

Ensuring that Japan-China and China-India competition does not slide into strategic conflict will nonetheless remain a key challenge in Asia. Never before in his-

tory have all three of these powers been strong at the same time.

The emergence of China as a global player is transforming the geopolitical landscape like no other development. Not since Japan rose to world-power status during the reign of the Meiji Emperor has another non-Western power emerged with such potential to alter the global order as China today. However, as history testifies, the rise of a new world power usually creates volatility in the international system, especially when the concerned power is not a democracy. Such has been the transformation of China that, while preserving communist rule and Confucian culture, it has gone in one generation from all ideology and token materialism, to all materialism and token ideology. China's ascent, however, is dividing Asia, not bringing Asian states closer.

Mr. Chellaney is a professor of strategic studies at the privately funded Center for Policy Research in New Delhi. This passage is excerpted from his book, Asian Juggernaut: The Rise of China, India and Japan, published by Harper-Collins in October 2006.



Economic powerhouse Japan is determined to shore up its security and, despite its concerns over the fraying ties with Beijing, wishes to ensure that China does not call the shots in East Asia. After its World War II ignominy, Japan turned a necessity into a virtue by defining an anti-war identity anchored in its U.S.-imposed constitution and a strategy emphasizing economic modernization and global peace. Now, it is starting to shed decades of pacifism and reassert itself in world affairs. India's continued economic rise, coupled with its political realism and growing self-confidence, has made it a key factor in Asian geopolitics. It will be unwilling to cede its leadership role in southern Asia.

In the emerging Asia, the two major non-Western democracies, India and Japan, look like natural allies as China drives them closer together. An India-Japan strategic partnership, involving naval cooperation to protect vital sea lanes of communication, could help adjust balance-of-power equations in Asia and build long-term stability and equilibrium.

THE DEEPENING MISTRUST and nationalistic chauvinism in Asia could create conditions that seriously harm the interests of all the major players. Take the divisive issue of history. The emphasis on past grievances only engenders nationalistic hostility and, as seen from the trends in China, South Korea and Japan, creates congenial conditions for the virus of xenophobia to spread in such homogenized societies. In order not to jeopardize stability and peace across Asia, sustained efforts need to be made to overcome the harmful historical legacies and the negative stereotyping of a rival state. China's communist leaders will have to refrain from using the history card against Japan, just as Japanese right-wing politicians, intent on reviving a spirit of militarism, need to stop peddling myths about

the benevolence of Japan's imperial past.

The international community cannot be a silent spectator to the motivated resurrection of unpleasant history today. Such revivalistic actions may be designed to bolster political legitimacy at home and whip up nationalism, but they harm regional growth and stability and challenge international norms on good-neighborly conduct. A sustained Asian renaissance demands a more hospitable political atmosphere to help Asia sharpen its competitive edge and innovative skills through greater intra-Asian cooperation and larger investments in the sciences. The setting aside of historical issues and inculcation of positive political values in education are essential to the building of genuine, enduring interstate partnerships in Asia.

Priority should also be given to a resolution of territorial and maritime disputes in Asia. The China-India-Japan strategic triangle cannot become stable without progress on that front. A first step to a settlement of any dispute is clarity on a line of control or appreciation of the "no go" areas in order to eschew provocative or unfriendly actions. China's gunboat diplomacy in September 2005 across the median line in the East China Sea, for instance, only aided the reelection campaign of Japanese leader Junichiro Koizumi. In his five years in office, Mr. Koizumi not only built popular support for revision of the pacifist Japanese Constitution but also laid the foundation for the emergence of a more muscular Japan.

The best way for China and Japan to explore for hydrocarbons in the East China Sea is through the joint development of fields there, given the intricate, difficult-to-resolve claims and legal ambiguities. Emulating the example of bilateral cooperative agreements set by disputants in the North Sea, Japan and China could jointly develop hydrocarbon deposits around the disputed Senkaku/Diaoyu Islands, which have be-

come symbols of potent nationalism. As a first step, Beijing and Tokyo need to reach agreement not to change the status quo. Joint development of fields where the Sino-Japanese maritime-boundary claims overlap can help bridge the dispute between the two countries.

Through a joint-development agreement under which they agree to share costs and benefits, China and Japan can positively transform the security environment in East Asia and help establish regional cooperation and multilateral security mechanisms. With the East China Sea potentially holding up to 100 billion barrels of oil, Japan and China have a strong incentive to reach a compromise.

THE TWO MOST populous nations on earth, China and India, have been scowling at each other across a 4,057-kilometer disputed frontier for more than half a century. Since 1981, India has been negotiating with China to settle the Indo-Tibetan frontier. These border talks are the longest between any two nations in modern world history. Yet, not only have the negotiations yielded no concrete progress on a settlement, but they also have failed so far to remove even the ambiguities plaguing the long line of control. Beijing has been so loath to clearly define the frontline that it suspended the exchange of maps with India several years ago. Consequently, India and China remain the only countries in the world not separated by a mutually defined frontline.

China's reluctance to fully define its long frontier with India may be linked to

its strategy to keep its neighbor under pressure by pinning down a large number of Indian troops along the inhospitable slopes and valleys of the Himalayas. But through such reluctance China only advertises itself as a problem state for India. It has, for example, accepted the colonial-era McMahon Line with Burma but not with India. It has also not defined

its 470-kilometer frontier with Bhutan, with crossborder Chinese incursions occurring periodically.

The China-India frontline, without prejudice to rival territorial claims, can be clarified through a mutual exchange of maps

showing each other's military positions. A Chinese disinclination to trade such maps translates into a greater aversion to clinch an overall border settlement. Rather than present itself as a practitioner of classical balance-of-power politics, China can profit more by fostering genuine political cooperation with New Delhi so that India is not driven into the U.S. strategic camp.

A genuine China-India rapprochement fundamentally demands a resolution of the Tibet issue through a process of reconciliation and healing initiated by Beijing with its Tibetan minority. Such a process will aid China's own internal security. Despite decades of ruthless repression, China has failed to win over the Tibetan people, whose struggle for self-rule remains a model movement. Such is the suppression in Tibet that even having a photograph of the Dalai Lama constitutes a criminal offense. Yet the Tibetans have not lost their sense of mission or the will to regain their rights.



FRED HARPER

It is an illusion that China and India can build enduring peace and cooperation without Beijing reaching out to Tibetans and solving the problem of Tibet. A problem that defines the origins of the China-India divide will stay at the center of that troubled relationship even if it were set aside indefinitely. China's own journey towards great-power status would be aided if it helped preserve Tibet's unique culture and religion, involved Tibetans in the development of their land, and reached a deal to bring the Dalai Lama back from his exile in Dharamsala, India. A placated Tibet could help bridge the China-India chasm.

TAIWAN IS ANOTHER Asian dispute that is far larger than the size of that island's population and area. Sitting astride vital sea lanes, Taiwan truly holds the key to whether China emerges as a stabilizing force or an arrogant power seeking unchallenged ascendancy in Asia. By staking its claim to a role in the security of Taiwan, Japan is signaling that it will not allow China to change East Asia's strategic balance in Beijing's favor. This signaling was best symbolized by the February 2005 U.S.-Japan security declaration that identified the peaceful resolution of the Taiwan issue as a shared strategic objective. Japan's interest to play a role in Taiwan's future is reflected in the growing view among Japanese politicians that Tokyo must come to the island's aid in the event of a Chinese invasion. A takeover of Taiwan will not only allow China to absorb the island's technology, weaponry and large foreign-exchange reserves, but it will also arm Beijing with the power to control shipping lanes to Japan and position missiles just 100 kilometers from the nearest Japanese territory.

Taiwan may be far from Indian shores but its political future also matters to India. In strategic terms, Taiwan can be to India what Pakistan is to China. Translat-

ed into policy that could entail close strategic collaboration between India and Taiwan, with the goal to aid each other's security through shared objectives and means, and help build equilibrium in Asia. Economically, the new Taiwan-India Cooperation Council symbolizes the island's effort to reduce its economic dependence on mainland China, which accounted for some 70% of Taiwan's accumulated off-shore investment and 38% of its total exports in 2005.

A new Indian strategic thrust towards Taiwan, however, may have to await a generational political change in India. In the near to medium term, strategic cooperation between Japan and Taiwan appears more conceivable, despite occasionally insensitive Japanese rhetoric, such as Foreign Minister Taro Aso's reported remark in February 2006 that Taiwan owes its high educational standards to enlightened Japanese policies during the island's 50-year occupation. Japan and India cannot be oblivious to the prospect that a Beijing-obedient Taiwan may presage movement towards a Beijing-oriented Asia.

Time clearly is on Taiwan's side. For more than a century, Taiwan has been outside the control of mainland China. A continuation of the status quo for another quarter-century will only bolster Taiwan's de facto independence, making it more difficult for Beijing to undo that.

ENERGY IS ANOTHER critical area where strategic friction can be forestalled through shared Asian interests to safeguard energy supplies and maximize resource conservation and efficiency in order to underpin economic growth and commercial competitiveness. Such common interests can be the basis of a cooperative approach in Asia that emphasizes the development of secure new energy assets and the adoption of energy-saving technologies and methods. Japan, a leader

Replicating European-style integration in Asia appears more problematic than ever.

in energy efficiency, can offer valuable assistance to the rapidly growing Asian economies. According to Japan's Natural Resources and Energy Agency, the Japanese industry's energy use is so efficient that it uses one-ninth the amount of oil that China does to generate the same profit.

A cooperative energy approach, of course, cannot be built without taming the two main Asian monsters—resurgent nationalism and the recrudescence of fiery historical grievances. Such an approach also will not be possible if any power seeks to control an ever-larger percentage of the world's energy resources. The present zero-sum game on energy impedes the development of new oil and gas fields in a high-potential resource area—the East China Sea. Furthermore, it obstructs cooperation on bringing Russian oil and gas to consumers in Northeast Asia in a major way so that the region's reliance on the volatile Persian Gulf region could be reduced.

Interstate cooperation on energy can help stem escalating tensions in Asia while allowing the harvesting of new resources to aid prosperity. But energy cooperation cannot be institutionalized or sustained on a long-term basis without expanded political and security cooperation as well as increased transparency on military expenditures. The unrelenting pace of China's ambitious military modernization even as its diplomacy becomes increasingly sophisticated indicates its intent to follow Theodore Roosevelt's dictum: "Speak softly, but carry a big stick." With opacity in planning and continuous, double-digit spending increases since before 1990, China's military buildup has advanced well beyond what most analysts envisaged just a decade ago. Beijing's barely disguised

ambition is to establish a blue-water navy ostensibly to secure its energy-supply lines. In that light, building interstate transparency on defense-spending levels in Asia has become necessary to help set up multilateral maritime-security and energy-cooperation arrangements.

The rise of strategic rivalries in Asia is also worrying because of the continent's conflicting political and strategic cultures and weak regional institutions. China, India and Japan, in fact, epitomize three distinct strategic cultures. The evolving equations between and among them confirm that globalization, far from sweeping away national identities, is helping to reinforce them. As a consequence, replicating European-style integration in Asia appears more problematic than ever.

Yet there is a greater need in Asia for political pragmatism and judicious diplomacy to ensure that China, India and Japan emerge as positive forces in international politics. If these powers and the other Asian states eschew nationalism-mongering and develop long-term cooperation, Asia will truly prosper and become stronger as the global pivot.

The central challenge now is not so much to create an Asian Union as to find ways to stabilize major-power relationships in Asia and promote cooperative approaches that can tackle security, energy, territorial, environmental, developmental and history issues. Rather than become the scene of a new cold war, Asia can chart a more stable future for itself through shared security and prosperity among its states. An inability to resolve all the disputes and problems should not hold up cooperation on issues that can be addressed. Nor should competition discourage collaboration. ■



2016: What's Next for Asia?

Editor's Note



FOR OUR 60TH anniversary, we decided to do something ambitious: Ask our contributors to go out on a limb and make predictions about Asia's future. We not only put the question to 12 of the most respected thought leaders in the region. We made it even more challenging by setting the time-frame at around 10 years.

Five years, you see, would have been too easy, because they could just project some current trends. Twenty years is too fun; writers can make fanciful guesses because nobody can really judge their accuracy—few will remember the predictions when 2026 actually rolls around. Ten years, though, that's hard. It requires some thought about what are the underlying forces that will shape this region.

We divided the contributors into three basic categories: culture and society, finance and services, and innovation and technology. To get the ball rolling, Joseph Cardinal Zen and Anwar Ibrahim, for in-

stance, tackled the most sensitive subject of prejudices against two of the largest religions. The KMT's Ma Ying-jeou foresaw a realistic *modus vivendi* emerging between the two sides of the Taiwan Strait. And Wang Dan, former leader of the Tiananmen student protests of 1989, gave his prescription for promoting the growth of civil society and hastening the arrival of democracy in China.

In the finance world, our contributors believe that China, India and Japan are not only converging on global standards of best practice, they will increasingly call the tempo for global change. And when it comes to technology, for the first time it is possible to contemplate Asian companies moving into leadership positions at the forefront of innovation.

These predictions may seem overly optimistic. Perhaps when we celebrate our 70th anniversary in 2016 we can assess the track record of our oracles. In the meantime it is at least comforting to note that all 12 are divining more good fortune ahead.

Zen-Like Optimism

by Danny Gittings

ASK HONG KONG'S Roman Catholic cardinal, Joseph Zen, to look 10 years into the future and the picture that emerges is an upbeat one. Democracy will take root not just in Hong Kong but across all of China, the outspoken 74-year-old confidently predicts. Beijing will be reconciled with the Vatican, allowing the Catholic Church to operate freely in China, and repressive measures like the one-child policy will be long gone. "We believers are always optimistic," the cardinal explains, as he gazes into the crystal ball in his small office next to Hong Kong's cathedral. "The good things are natural, the bad things are unnatural. All the distortions cannot last for ever."

Cardinal Zen has had plenty to say about those bad things in recent years. His strong attack on the slow pace of democratization in Hong Kong earned him the enmity of Beijing, which reacted angrily to his elevation to cardinal early this year. A row over what the Catholic Church saw as Beijing's "illegal" ordinations of two Chinese bishops in the spring, without the Vatican's approval, strained relations still further. Beijing severed relations with the Vatican in 1951 and, until these are restored, many millions of Catholics in China risk persecution by worshipping in secret underground services. The only officially allowed church is the state-run Chinese Patriotic Catholic Association, a Communist-controlled body which is not recognized by the Holy See.

Like all bad things, the cardinal is convinced this situation can not last much

longer. He sees the "illegal" ordinations as the last gasp of the Communist cadres charged with "managing" religious affairs. In his view, they are desperate to



stop any rapprochement as it would render their jobs redundant. Instead he scoffs at my suggestion that it could take another 10 years to strike a deal that would get the Catholic Church back into China. "It can be much earlier," he says. "There is nothing they should be afraid of. The Catholic Church is such a small minority. The Chinese Catholics are so patient and obedient and submissive. The moment they understand that, I think

the agreement is very easily achieved."

Even the recent row buttresses the cardinal's optimism. Until a decade or so, such "illegal" ordinations would have been unremarkable, since all new Chinese bishops were appointed without any input from the Vatican. It was only in recent years that Beijing began to turn a blind eye to aspiring bishops quietly seeking the Holy See's blessing. As a result, apart from those two recent exceptions, all new ordinations now enjoy the Vatican's approval. The cardinal cites that change as an example to justify his confidence that things will continue to change for the better in China over the next decade. In this particular case, the change may have taken nearly half a century to achieve, since the breaking of Sino-Vatican ties in 1951. Even now the leadership's official position remains that the Holy See has no role in who is ordained in China.

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But Cardinal Zen is confident that other changes will come much faster in the next few years. "History is accelerating," he says. "What happened in centuries now happens in 50 years. So what happened in 50 years can now happen in 10 years." As justification, he points to the breakdown of the Communist Party's control on the flow of information. Beijing may still censor the media and erect a great firewall to try—with mixed success—to limit what can be seen on the Internet. But having decided to allow ordinary Chinese to travel overseas freely, it cannot control the images that they bring home with them. That includes a world where people can have as many children as they like, further contributing to the crumbling of a one-child policy which is already flouted in many parts of the country. "What they see is a world where people, in general, enjoy freedom," he says. "So they will go home and demand to enjoy the freedoms enjoyed by people elsewhere."

That explains Cardinal Zen's optimism that the China of a decade hence will be a free and democratic one. Like many others, he believes Hong Kong could serve as a role model. In recent years, the cardinal has been sharply critical of the territory's Beijing-appointed leadership for failing to push universal suffrage more vigorously. But he holds out hope that the situation could change for the better next year if, as expected, Chief Executive Donald Tsang is reappointed for a further five years. Since that would be Mr. Tsang's final term in office, the chief executive will no longer be so dependent on the blessing of his Beijing masters. Perhaps he will even become "a little more daring," the cardinal suggests.

It's not just Hong Kong that he expects to move toward democracy over the next decade. Pointing to the elections for village chiefs that are now well established at a local level throughout China, the car-

dinal suggests that democracy is already beginning to take root in China. That's a view which is open to question given the well publicized examples of villagers being punished for trying to exercise their democratic rights over the past year. Nor does the cardinal expect the process to be complete by 2016. Instead he shares the view of many Sinologists that democracy is most likely to begin with the Communist Party itself—with elections among the party's more than 60 million members to fill top leadership posts. But it does mean a China in which there'll be significant progress in that direction. Cardinal Zen warns that doing nothing is not an option: "We hope for a peaceful evolution ... The term is not liked by the Chinese regime but they should realize that it's the only alternative to a revolution and the sort of chaos we saw in Yugoslavia."

Despite his outspokenness on the importance of democracy, the cardinal is quick to distance the church from any direct role in trying to bring it about. China is not Poland, he says. With only five million to 10 million Catholics (the exact number is difficult to estimate when so many continue to worship underground), the church is in no position to lead a civil movement. Instead it has other challenges to confront over the coming decade. With rapid economic growth has come a rising materialism that has left the church struggling in China's more prosperous cities. While the number of Catholics continues to grow in poorer inland provinces such as Hebei, in Shanghai the church has such difficulty finding anyone who wants to be a priest that it has to import them from the hinterland.

Here too Cardinal Zen is optimistic the situation will improve. With the normalization of Sino-Vatican ties that he confidently expects is only a matter of years away will come the ability to send clergy into China to help fight the forces of secularization.

“Once you have a good clergy then you have a good congregation,” he says. “Once you have a better staff in the seminary then they are in a stronger position to resist the temptations of money and power.”

The cardinal is reluctant to talk numbers. Churches in post-Communist countries such as Hungary have struggled to win more converts, discovering that the lingering influence of an atheist regime is hard to dispel. Instead he sees the real goal over the next decade as further improving the life of China’s existing Catholics—rather than greatly boosting their numbers.

The cardinal’s predictions of democracy within a decade may be more hope than reality. But his optimism on the fu-

ture of the church in China appears more firmly buttressed by recent developments. In August, Bishop An Shuxin, an underground priest from Hebei province, was released from jail. While several others bishops remain imprisoned, and many more Catholics continue to face persecution, the trend is an encouraging one. With a delegation from the Holy See having already visited Beijing in the summer to smooth relations after the ordinations row, many believe a Sino-Vatican rapprochement is only a few years away.

And when Cardinal Zen speaks of the brighter future that China’s Catholics will enjoy in 10 years time he is voicing a goal that seems eminently achievable.

Radical Islam in Southeast Asia

by Anwar Ibrahim

IN THE WAR against terrorism, the United States regards Southeast Asia as a “second front,” with attention focused on radical Islamist groups said to be working with al Qaeda. This appellation belies the region’s tradition of tolerance and its demonstrated modernist outlook with respect to the importance of the rule of law and preservation of human rights. While perpetrators and purveyors of violence deserve swift retribution, over the coming decade radicalizing trends can be dissuaded by emphasizing the peaceful and democratic traditions of the region rather than providing governments with carte blanche to trample on human rights and civil liberties in the name of national security.

In attempting to frame a discourse of the impact of Islam in the governments of

Southeast Asia, policy makers as well as academics are prone to view Islam in binary terms: it’s either moderate or extremist, liberal or conservative, reformist or traditional. This of course is a throwback to the Orientalist slant of the past with its propensity for sweeping generalizations. One will recall, for instance, Clifford Geertz’s *The Religion of Java* (Glencoe: Free Press, 1960) where Javanese society was seen as essentially bipolar in terms of its religious orientation—as between Santri and Abangan, the former representing the religious and pious minority group led by their *kyai*, living in communal *pesantren*, and the lat-



~ Mr. Anwar, a former deputy prime minister of Malaysia, is a visiting professor at Georgetown University in Washington, D.C.

ter comprising the majority of Javanese, supposedly merely nominal Muslims, being very much attached to the Javanese pre-Islamic art forms and practices, and largely heedless of their religious obligations. These same *pesantren*, just like *madrassas* in other parts of Southeast Asia as well as in Pakistan, are now regarded as hotbeds for the breeding of Muslim fundamentalists. The upshot of such a perception is to pigeonhole organizations founded on Islamic precepts as being radical with a tendency of turning into or associating with terrorist bodies, no doubt a manifestation of a prejudiced and Islamophobic mindset which prevents one from discerning between mainstream political Islam and its more extremist peripheries.

This oversimplified view is unfortunately shared by the so-called enlightened statesmen in the region. Their formula for responding to radicalism has been policy prescriptions based on firepower, economic strength and an overall patronizing attitude towards the Muslim communities. Surely such a policy cannot be sustained in the long term nor can it be regarded as one based on foresight and wisdom. It fails to recognize that Muslim-dominant countries such as Malaysia and Indonesia in the past effectively checked the spread of communist movements such as the Malayan Communist Party and the Partai Komunis Indonesia.

For example, the conventional view that attributes the failure of the communist insurgency in Malaysia solely to the policy of the British colonial powers in winning "the hearts and minds" of the people is flawed in as much as it ignores the role of Muslim scholars and organizations in countering the psychological warfare of the communists. It also disregards the long history of moderation that so typifies Islam in Southeast Asia and has enabled its communities to resist the ideological onslaughts of the resurgence of

the early decades of the last century in the Middle East. Sound policies for engaging Muslims cannot be formulated without a thorough understanding of this unique historical experience, and this understanding will not come from clichéd notions of Islam nor by viewing political Islam as a dangerous monolith. The approach must be based on a sustained commitment to build upon the overriding feature of moderation and to help in the most unobtrusive way to preserve its legacy while actively engaging the more radical sectors.

Unfortunately governments in the region have forsaken a more moderate strategy of tolerance and accommodation while pursuing pro-growth economic policies, and have instead embraced the new theology of antiterrorism. In doing so they are walking on egg shells by embracing the U.S., a partner whose foreign policy is marked by that Wilsonian determination that led it to invade Iraq unilaterally. It should come as no surprise that prescriptions for the security of the region issuing from America are treated with skepticism, particularly by Muslim communities, which see the familiar pattern of Draconian laws clouded in secrecy now surfacing from an unlikely co-conspirator.

No doubt this is symptomatic of the rise in anti-American sentiment. But the spread of Islamic radicalism in Southeast Asia must be understood in the broader context of the region's history and not only through the lens of Sept. 11. While the ascription of extraneous causes such as sympathies with the plight of the Palestinians or the unjust occupation of Iraq does carry a certain air of justification, it doesn't take long to see that after separating the romance from the hard facts, the problems are essentially homegrown and far more varied than the generic label of al Qaeda would suggest.

Looking to the future, there are sever-

al challenges that must be addressed throughout Southeast Asia. In southern Thailand, where increasing radicalism of Muslims tends to hog the headlines for the wrong reasons, it is imperative that the powers that be address the fundamental causes which hark back to centuries of demand for self-rule. Again, a policy predicated on a systematic effort to eradicate the mother tongue of a community, apart from being manifestly racist, is doomed to failure. Fortunately the recent statements by the Thai authorities that they are prepared to negotiate with the separatists should be viewed as a positive development giving hope that an equitable and just resolution may be in sight.

While we know that the recent terrorist outbursts in Manila were more in the mold of the Bali bombings, the authorities should not forget that the Moro uprising in the southern Philippines more than 20 years ago stemmed from political and socioeconomic factors which have no bearing with the current acts of terror. It had everything to do with the marginalization of poor Muslims, so that while such disadvantages continue unchecked radical groups are bound to grow.

Indonesia has moved past the New Order and into the era of *reformasi*, having emerged from the ruins of a military dictatorship. Who are we to remind them of the evils of government based on tyranny, coercion and repression? On the contrary, we should take lessons from the bitter consequences suffered as a result of such a protracted reign of unchecked power which also saw the violent explosion of interethnic killing and bloodshed.

In this regard, the racist chanting of certain leaders is a grim reminder of the devastating impact of absolute power. When government policies are drawn along chauvinistic lines and marked by discriminatory practices, discontent is bound to foment. This problem must be

tackled at the core while allowing for civil society to blossom. Democratic space must continue to be opened and not further eroded. In Malaysia, the call by dissident voices has been to move beyond the decades-old paradigm of the New Economic Policy and forge a blueprint to narrow the economic divide regardless of ethnic lines. This new vision contrasts sharply with Lee Kwan Yew's recent hectoring of Singapore's neighbors not to marginalize their Chinese citizens. His rant is emblematic of the older generation of leaders trapped in the mindset of race-based politics that prohibits greater social cohesion and development. What about the plight of the majority of Malays, the Indians and the estimated 40 million abject poor in Indonesia or even the predicament of the minority Malays in Singapore?

There is no denying that imported terrorism has stoked the domestic radical fire and led to despicable acts of violence in the region. This is clearly an aberration confined to small pockets. However it would be shortsighted if the policies adopted in Southeast Asia in response to these threats were too heavy-handed and dictated in large part by the expediency of relations with a superpower. By asking the right questions and reaching the correct conclusions, it is clear that we must deal effectively with the causes or risk fanning the flames. My hope is that we in Asia can, in the next decade, discover the confidence and resolve to recognize the rights of the people and to oppose those who would usurp those freedoms. As the region moves down the path of democracy it should firmly embrace its intrinsically pluralistic culture and work to adopt pro-growth and market-driven policies that will ensure a more sustainable development. A prosperous future is indivisible from a firm commitment to the principles of distributive justice, the rule of law and a profound respect for human rights.

Taiwan: A Responsible Stakeholder

by Ma Ying-jeou

SEVERAL MAJOR CHANGES have taken place in the relationship between Taiwan and the Chinese mainland in the last 10 years. For one, cross-strait relations have continuously



deteriorated from a relationship characterized by coexistence and exchange to one marked by confrontation and distrust. Placed among the big-power structure, Taiwan is increasingly becoming “a tail that wags two (or even three) dogs.”

Second, mainland China has been growing at astonishingly rapid rates both economically and militarily. This presents an unprecedented and extremely challenging situation for Taiwan, an island so nearby and poorly endowed in natural resources, yet rich in political and economic developmental experiences. Present-day China is at once a huge “threat” and an enormous “opportunity,” affecting the psyche and livelihood of most people in Taiwan.

Third, after five decades of nonstop economic growth and more recent democratization, Taiwan has been undergoing an unprecedented and extremely painful downturn. Not only has the economic picture dimmed considerably but popular faith in Taiwan’s democracy has also declined. Worse still, the social fabric has been torn asunder due to overzealous political mobilization and sharp differences over systemic and policy issues. This renders Taiwan increasingly unable to cope with the dynamic challenges facing it from within and without.

This ought to change. The Taiwanese people deserve more and the world would be better off without one more hot spot in the Taiwan Strait. And I happen to believe that the circumstances in Taiwan and in the Strait are now conducive to the dawning of a new decade of peace and prosperity. The Kuomintang of which I serve as chairman will certainly strive to bring it to fruition.

Neither Unification Nor Independence

SINCE THE CROSS-STRAIT relationship is at the root of regional tension, internal bickering and Taiwan’s economic stagnation, I will seek as a top priority to stabilize the relationship by maintaining the status quo for the foreseeable future. In other words, I will pursue neither unification nor independence. In fact, during the last decade, this status quo policy has been the staple of the KMT’s mainland policy. It has unfortunately been misunderstood and misconstrued sometimes. But I believe it is abundantly clear that the KMT’s policy has always been different from, and often-times struggling vehemently against, both Beijing’s policy and that of the current ruling party in Taiwan, the Democratic Progressive Party.

In the second half of the 1990s, Beijing sought to promote “unification” to the point of discussing the idea of a “unification timetable” in public. And since 2000 the DPP administration under President Chen Shui-bian has been unmistakably pursuing a pro-independence policy, to the

~ Mr. Ma is mayor of Taipei City and chairman of the Kuomintang.

point of making explicit his "independence timetable," i.e., to write a new constitution for Taiwan in 2006 and implement it in 2008. Both failed miserably.

Beijing failed because it not only failed to bring about unification, but also galvanized all the pro-independence forces in Taiwan into resistance and an even more adventurous policy. Likewise, the DPP and President Chen failed because their policy brought Taiwan to unprecedented decline and division at home, and to near disaster in its external relations. Now I believe both the pro-unification and pro-independence forces have learned painful lessons. Hopefully, the KMT's status quo policy will be given a try.

To maintain the status quo, I would echo what President Chen promulgated in his inauguration speech on May 20, 2000 generally known as the "Five Nos." That is, we will not declare independence; we will not change the national title; we will not push forth the inclusion of the so-called "state-to-state" description in the Constitution; we will not promote a referendum to change the status quo in regard to the question of independence or unification; and finally, the abolition of the National Unification Council or the National Unification Guidelines will not be an issue.

But a status quo is never static. In view of the changing circumstances, Taiwan should adopt a policy that would enable it to resist the rising "threat" to Taiwan's security and at the same time allow it to take advantage of the growing "opportunity" available in the China market. It is not an easy task. But Taiwan has to strike a balance between them—to focus on one to the exclusion of the other is not only ineffectual but illusory. To do so Taiwan has to "walk on two legs." One of the legs is a strong and credible defense. The other is a moderate and mutually beneficial cross-strait relationship.

To ensure sufficient defense, Taiwan

has to continue with its defense modernization and reform. It has to continue to replenish and renew its advanced weaponry inventory to the extent that it would deter or dissuade Beijing from attacking the island. It should also maintain a robust political and military relationship with the United States, its longtime friend and ally. Not the least, Taiwan's leadership should take the initiative in reconciling internal differences and rebuilding a sense of unity.

On the pending arms bill, the KMT will strive for consensus with other political parties and find a generally acceptable solution during this autumn session. National security is too important to be made a hostage to a domestic brawl. Delinking the two would be a useful first step before Taiwan's rowdy democratic process is to churn out some consensus on what constitutes national security itself.

The "Five Dos"

TO EFFECT A new period of rapprochement in the cross-strait relations, I proposed a program of "Five Dos" early this year. They are as follows:

- ✿ Taipei and Beijing could resume dialogue on the basis of the so-called "92 Consensus" which in our view was, "One China, Different Interpretations." It is a gross anomaly, to say the least, for the people on both sides of the Strait to engage in such a large amount of exchange, and yet for the governments to find excuses not to talk to each other as has been the case for the last six years.

- ✿ The two sides conclude a peace agreement of 30-50 years, including military confidence building measures, thereby formally terminating the current state of hostilities. I believe it is in everybody's interest for the process to begin at some point in the future.

- ✿ The two sides normalize economic

relations by starting with direct air links, expanding visitation of mainland tourists, permitting financial services industry to invest on the Chinese mainland, and enlarging other economic exchanges, leading eventually toward a cross-Straits common market. This will instantly create a win-win situation, and perhaps a win-win-win one, if the regional interest is considered.

✱ Taipei and Beijing should jointly develop a *modus vivendi* for Taiwan's international participation, bilateral and multilateral. This thorny issue has plagued the cross-Straits relations as well as the international community for decades and is to no one's benefit. It is high time for the two parties directly involved to iron out a solution and spare the world more unnecessary skirmishes. The name of the game should not be zero-sum, but pragmatism. And, to look at the issue with an open mind, I believe anyone would "rediscover" the world to be truly big enough to accom-

modate both Taiwan and the mainland at the same time.

✱ The two sides should expand the current exchanges in cultural and educational areas. Judging from the European experience, a region where two world wars were ignited, these exchanges, particularly among the young students, have proved to be instrumental to enhancing mutual understanding and hence essential to sustained peace in the postwar period.

None of the above would be an easy task. But any long journey must begin with the first step, and any step with a will. I believe that after six long years of instability and decline, Taiwan is ready for change. By moving beyond its role as "a tail that wags two dogs," Taiwan has a lot to offer to the region, including its experiences in economic development and political democratization. After accomplishing an economic miracle and democratization, it is time for Taiwan to learn to be a responsible stakeholder in the region.

Cultivating Civil Society in China

by Wang Dan

CONTRARY TO MOST expectations, the Chinese reforms and subsequent economic growth have not led to liberty and democracy. In fact, the success of the economic reforms has become the best excuse for the communist regime to reject freedom and democracy. However, one positive development is that, since the early 1990s, shoots of civil society have begun to sprout within China. As more Chinese enter the private sector, the state is no longer able to control every aspect of daily life in the same way as it used to. On the contrary, people are starting to recognize the importance of monitoring the state and making the government more accountable. And as the Internet and mod-

ern telecommunications have become part of everyday life, it has become easier to break through the government's control of news and information and to organize campaigns for basic rights, be they the right to private property or freedom of speech. This provides a stronger basis for continuing the fight for democracy in China.

The construction of a mature and powerful civil society is critical to China's social development and democratic progress. Its significance is that it will not only train people's democratic consciousness during

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the construction of a civil society, and so promote the realization of democracy, but also set a sound foundation to stabilize any future democratic system, so that the democratization process will not retrogress. So while Western governments continue to deal with the Chinese authorities, they should not lose sight of those potential leading forces that are giving rise to a civil society. To deal with the Chinese Communist Party is to deal with China of today, but to deal with the growing civil society is to deal with the China of tomorrow.

Looking to the future of China, despite the many looming difficulties and crises I am still optimistic about the prospects for democratization. Sooner or later China will democratize. I think that it is very important for the generation that experienced the Tiananmen Square massacres—what we now call the '89 generation—to rethink and remember the past. But even more important, our generation must look forward and create something new for the future. This includes initiating both ideological and institutional changes. For the former, our generation advocates four basic values. These include prosperity, stability, freedom and social justice. The greatest difference between the opinion of our generation and that of the Chinese Communist Party is that the Party cares only about prosperity and stability. In contrast, the members of the '89 generation know that without freedom and social justice there cannot be sustained prosperity and stability.

For the institutional changes, our generation advocates the "four 'isms,'" which are: liberalism, which has at its core social justice; federalism which is aimed at resolving the problems between the central and local governments, as well as other problems such as Taiwan and Tibet; nationalism, but a moderate and democratic

nationalism to meld together a new national spirit; and constitutionalism, which will be the framework of the new political system. Based on these four values, we are looking forward to a new "third republic" which will be different from that of Sun Yat-sen's first republic and Mao Zedong's second republic. I strongly believe that this new republic will be a good friend of the United States and a responsible member of the international community.

Yet the question remains: How can international society cultivate China's civil society? I think that the international society can help China to establish civil society by starting with the following three aspects:

- ✱ *Support and help opposition movements.* At present, not only many exiled overseas Chinese dissidents promote democracy, but also more people within China participate in opposition movements. The opposition movement itself is a part of civil society, and the outside world should support it. As China's domestic opposition movement deems that external support may bring political risks, international support to the overseas-based Chinese democratic movement becomes even more important because this support will affect the domestic opposition movement.

- ✱ *Support and help local Chinese NGOs.* These form an important basis for civil society. Therefore, training Chinese people to manage themselves through NGOs or similar organizations is important for establishing civil society. Local NGOs have already been formed, especially in the areas of education, medical care, as well as to offer support for minority groups, and promote environmental protection. These organizations need support from abroad.

- ✱ *Support and help public intellectuals.* In China today, more and more intellectuals have started to participate in political



life. They not only hope to act as torchbearers, but also to participate actively in many social activities such as legal disputes and grass-roots elections. They are the vanguards of civil society, and they can accelerate the construction of a civil society if they can obtain powerful support.

Based on this, I propose three concrete suggestions:

- *International NGOs and nongovernmental forces should promote and publicize the importance of establishing a civil society in China.* This could be done by lobbying governments and media to pressure China

to foster the development of civil society.

- *International NGOs should hold more seminars to discuss China, and ask Chinese dissidents and common people to participate.* This will allow them to make their causes known to the world. In turn, the international exposure will mean that their message will be fed back to China, making it more powerful.

- *Carry out leadership training for local Chinese NGOs.* Foreign democratic movements could share their experiences and know-how with their Chinese counterparts.

A Mature Society Embraces Prosperity

by Anand G. Mahindra

PERHAPS I SHOULDN'T have consulted Wikipedia before writing this article. When I tapped out the keywords "consumer culture" in the search box, a rather unsettling definition was hurled back at me: "Consumerism is a



term used to describe the effects of equating personal happiness with purchasing material possessions and consumption."

Suddenly, all my accumulated enthusiasm for India's shiny-faced, eager and ubiquitous shopaholics came under assault. Until now, I had thought those mall marauders were India's new heroes, since their propensity to spend had resulted in a consumption-led spurt in our hitherto sleepy GDP growth rate. Thanks to their desire for the good life, we were being perceived as the (potentially) new rich kids on the global block, rubbing shoulders with the heroically mercantilist Chinese.

But despite this new-found status, I doubt most Indians would accept the indictment that their nirvana now comes in the form of a new fridge or motorcycle. The dominant cultural attitude is still one of ambivalence toward the sudden wealth that is on offer. This is no surprise, given the residual poverty and deprivation that characterize not just the remotest villages, but even advanced Indian cities such as Bombay, New Delhi—even high-tech Bangalore.

So India's socialist ethos still lingers in not just Fabian bureaucrats but also in some corners of the average Indian's mind. Small wonder, then, that a current Bollywood blockbuster, *Lage Raho Munnabhai* (directed by Rajkumar Hirani), employs hip argot to advocate the revival of Gandhian ideals: austerity, humility and social equity. Yet, this has not deterred India's teeming millions from adopting shopping as the new national pastime. Is it just hypocrisy then?

~ Mr. Mahindra is vice chairman and managing director of Mahindra & Mahindra Ltd.

The number of people living below the poverty line is diminishing, and income distribution is being transformed from the traditional pyramid shape to a more barrel-shaped one. A recent study shows that the rate of growth of spending on discretionary items, beyond basic necessities, has been growing at an average of 9% per year over the past five years. Fueling this growth is the fact that Indian consumers are the most optimistic in the world, according to an A.C. Nielsen survey.

Interestingly, the bulk of consumption growth is not accounted for by these mall-goers, since the latter constitute just the "creamy layer" of Indian society. The real growth is coming from upwardly mobile lower-income classes—both urban and rural—that have begun spending on a deeper and more diverse basket of basic goods.

India's development has been somewhat unconventional when you consider that China and other East Asian nations commenced their upward trajectories with investment and export-led growth. The ensuing wealth subsequently fueled domestic consumption. External trade in India, on the other hand, still comprises a small percentage of GDP and indigenous consumption has been the initial stimulant of our economic progress.

Gratifyingly, this consumption hasn't grown at the cost of investment. Savings and investment rates have increased to 29% and 30% respectively in 2005 from 25% and 26% in 2000. India is also fortunate in that its capital productivity is respectable and incremental capital output ratio is higher than China's. It would not be unreasonable, then, to expect that if these savings and investments begin to translate into capacity creation, we can expect a steady increase in the supply of goods that will improve economies of scale and export competitiveness.

At the same time, if the government plays ball—which it shows signs of doing—

and channels those savings into long-overdue infrastructure creation, an investment-led cycle can be expected to induce a surge in exports of manufactured goods. This will, in turn, sustain high growth rates and prevent the consumption boom from running out of steam.

How did this bullish scenario replace, in a relatively short time, the stereotype of India's hopelessness due to its phlegmatic "Hindu rate of growth"? Change, when it comes in India, is rarely dramatic, but is usually enduring and inexorable. So too, in the case of our economic reforms, which were creeping but relentless. The fall of the Berlin Wall in 1989—the reverberations of which were felt in India—marks the point when economic ideologies began to converge despite the profusion of political parties and philosophies. Shortly thereafter, the foreign-exchange crisis of 1991 led to the dismantling of regulations and the creation of elbow room for entrepreneurialism.

And—as if on cue in a grand opera—infotech entrepreneurs seized the day and enhanced not just their own net worth, but the country's brand equity abroad. Meanwhile, back in the "old" economy, rusty manufacturing companies quietly responded to the threat of free-market competition by re-engineering themselves and making dramatic productivity gains. Even as lowly call centers proliferated during the late 1990s, the world's more savvy multinationals discovered that India was a potential source of low-cost innovation—a sweatshop not just for labor but for brain ware as well.

Lubricating all these developments was an unprecedented rise in global liquidity which hungered for new investment destinations. Agonizingly slow, but irrevocable reforms in financial and capital markets saw a welcome inflow of capital that helped stock markets and distributed wealth and confidence to a new breed of consumers.

The world began sensing that there was another economic juggernaut in the making in Asia. Appropriately, the word "juggernaut" comes from the giant Jagannath temple on wheels that is unstoppable.

What then could stop the Indian consumer in his or her tracks? Could it be the ambivalence towards wealth mentioned above? At the risk of being seen as unswervingly optimistic, I would like to claim that this bewildering duality between increased consumption on the one hand and nonmaterialistic values on the other is not a sign of hypocrisy, but of a mature society. I would submit that in countries where democracy has not been experienced in its unconstrained form, you are more likely to find unbridled and unquestioned materialism; there are few other temples to worship at.

On the other hand, debate and dissent flourish in any society where political free-

dom is revered. In such societies, it is inevitable that a sudden and rapid rise in wealth, especially if it is unevenly distributed at the outset, will be accompanied by a chorus of protest and demands for introspection. A feisty and irreverent press, and an independent judiciary only amplify the pitch of the debate.

Rather than being alarmed by the cacophony of ideas, think of this as India's strength. We have thrived for centuries on being a place that indulges a multiplicity of everything ranging from religions to ethnicities to ideas. Not only does freedom of expression ensure greater social stability in the long run, but it is increasingly proving to be the hallmark of an innovative society. And if innovation, as many now claim, is going to be the most reliable and enduring source of wealth creation, then you can count on the tribe of eager and free-spending Indian consumers to proliferate. ■

Opening Japan's Banks

by Colum Murphy

STEPPING INTO SHINSEI Bank's colorful head-office branch in downtown Tokyo is like entering a futuristic space station: Giant liquid-crystal display screens flash real-time financial information and rows of computers provide high-speed Internet access. Gone are the matronly lobby assistants—the once ubiquitous feature of Japanese banks, on hand to guide customers through the maze of forms and confusing queuing procedures. In their place, the branch manager mans a workstation strategically located near the entrance, directing customers to the appropriate counters or to plush advisory booths.

The helpful touch at the front door is just one of many customer-friendly innovations that Shinsei has introduced into Japan's stuffy banking industry. Revolutionary for Japan, the bank was the first to abolish most ATM charges and was an early proponent of Internet banking. In the five short years since Shinsei entered the retail banking segment, it has managed to attract an impressive 1.8 million customers—and is adding 20,000 more each month.

More importantly, it is profitable: In fiscal year 2005 the bank reported net income of \$647.8 million and a return on assets of 0.8%. That's better than Japanese rivals, who currently report ROA ratios between 0.4% to 0.5%, but behind many international banks—Citigroup, for example, had an ROA of 1.65% in fiscal 2005.

Thierry Porté has been a key player in this renaissance. A native New Yorker and a long-time Japan hand, 49-year-old Mr. Porté joined Shinsei as vice chairman and

chief executive officer in 2003 from Morgan Stanley, taking over full control from oil and banking industry iconoclast Yashiro Masamoto in June 2005. With a “make-this-quick,” business-like attitude, Mr. Porté sits down to talk with the REVIEW in a spacious meeting room on the 19th floor of the bank's headquarters.



In contrast to the trendy environment of the branch on the lobby floor, this meeting room could be in the offices of any large Japanese company: simple, functional and depressingly austere. Outside, a spectacular view of Hibiya Park with the Imperial Palace on the distant left, and the towering buildings of Otemachi, Tokyo's Wall Street, on the horizon to the right, are both powerful reminders that conservative Japan is not far away.

The last 10 years were, without doubt, the most disastrous in Japan's banking history, but asking Mr. Porté to characterize the decade emits only an understated response: “Challenging,” Mr. Porté says with a laugh. “Difficult,” he offers. And in a brave effort to accentuate the positive, adds: “But the system has survived and is in a stronger position today than it has been probably for 20 years.”

The future financial health of Japanese banks, Mr. Porté believes, depends largely on how much they can increase sources of noninterest income, including fees for value-added services such as investment advice. This might be easier said than done. Up to now, apart from ATM and bank-

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transfer fees, Japanese consumers have balked at paying fees.

Even so, Mr. Porté is confident this will change: "We are in a country that has the highest number of Louis Vuitton bags per person," he says in a reference to the French luxury goods brand. "It's not as if people are not willing to pay for something if they perceive a brand, or quality, or an experience which they desire," he says, adding that it is only a matter of time before this concept is translated into Japan's financial services industry. That Shinsei has, thus far, made its name by cutting ATM fees in no way contradicts this, he says. The trick, Mr. Porté explains, is to know which services to charge for and which ones should be free.

Shinsei's performance so far is impressive—especially given its newcomer status in the retail banking market and the bank's checkered past. In the 1990s, under its previous name of the Long Term Credit Bank of Japan, the bank was synonymous with Japan's nonperforming loan problem. LTCB received government injections worth hundreds of millions of dollars in early 1998 and was nationalized later that year. The following year, it was bought out by U.S. private equity fund Ripplewood Holdings, which promptly set about relaunching and renaming the bank ("Shinsei" means rebirth), and redefining its business model.

Strong performance in Shinsei's retail banking division has helped buoy the bank, but it still only contributed only 15% of total revenue in fiscal year 2005, which ended March 31, 2006. And while there is a plan eventually to grow the segment to around one-third of the total business on a revenue basis, for now the bank relies on its institutional-banking division and its consumer- and commercial-finance division for the bulk of its business. Those two segments generated 41% and 44% of bank revenues, respectively, in fiscal 2005.

Yet institutional banking in Japan is characterized by low returns on corporate lending. For Shinsei, and indeed many Japanese banks, that sometimes means having to treat lending as a loss leader, and cross-selling customers on greater value-added products and services such as securitization, advisory work, hedging products, corporate restructuring and private equity.

Evolving the bank into what could be described as a "niche investment bank" would be challenging under the best of conditions. But in Japan, where serious debate on corporate governance has really only just begun, the going will be even tougher. Why? Mr. Porté sees poor corporate governance as limiting the development and growth prospects of the Japanese economy and, by extension, Japanese corporations—the core customers of Japan's banking sector.

To date, progress on corporate governance in Japan has been quite disappointing: "I think there have been some changes, but still the majority of Japanese companies today consist entirely, or almost entirely, of insiders on the corporate boards," he says. "As long as that continues, we are still quite a distance from what people would consider to be an appropriate standard of governance."

But an increase in shareholder activism offers no panacea. "There may be more activists in Japan these days, but they are not doing very well," he says.

"As long as corporate boards are dominated by insiders, and as long as you can issue shares and dilute minority shareholders without having recourse to a shareholders' meeting—it is hard for me to see that we are going to have substantial change anytime soon.

"I think we still have to have a discussion in Japan about a proper takeover code, and we also have to have further discussion about what needs to be approved at

shareholders' meeting and what can be approved at a board meeting," he says.

However, the incentive to have this discussion is just not there yet. For the debate to take place, the impetus has to come from the market, and in particular institutional investors. "They have to demand it," he says. "[But] we are not there at this point." According to Mr. Porté, most of Japan's institutional investors are conflicted because they too are controlled by insiders. "Will they attack others when they aren't willing to reform themselves?" Mr. Porté asks.

Hostile bids are also not the way forward, however. What is really needed, he says, is for Japanese companies to find the courage to identify underperforming businesses or units—and dispose of them quickly. Part of the problem is that Japanese companies consider affiliates or business units as their "children": "You never sell your children. Or you sell the child by the time it reaches 85 years old and is quite enfeebled," explains Mr. Porté.

This bleak picture of corporate governance aside, there are some other glimmers of light on the horizon of the Japanese banking industry. In the domestic market, retirement and individual financial services will bring great growth opportunities. Similarly, the market for real-estate finance and securitization is growing, and Japan's "huge" public-sector deficit—on a national, regional and local government level—should see the market for public finance grow strongly, he says.

International expansion, too, offers some growth opportunities, but any move abroad should be focused on those areas where Japanese banks have a clear competitive advantage, Mr. Porté cautions. For Shinsei that means sticking to what it knows best (NPL-related services, for now) and expanding to countries where this

know-how is in high demand. To date, Shinsei's modest international expansion has included Germany, South Korea and Taiwan, and in the future may involve expansion to the NPL-afflicted economies of China and India.

So how will Japan's banking landscape look a decade from now? "I think you will have a much more effective and efficient banking system that will be doing a much better job of serving individuals as well as institutions," predicts Mr. Porté.

"Tokyo will still be an important financial center, not necessarily the most important, but I expect it to be one that will be much more open to the world," he continues. "I don't think any one Asian center will be dominant. Hong Kong will be important, Singapore will be important. I am not sure if I am ready to venture a guess about Shanghai and Beijing but I presume they will be important. I think Mumbai will be important."

"The greatest risk in Japan today is complacency," says Mr. Porté. "[Although] there are enough threats out there—China as a competitor, North Korea, [potential] energy crises—that Japan needs to pay attention to, and that hopefully will prod a change process."

But as one banking analyst at a European investment bank sees it, even these threats will not be enough to force Japanese banks to execute the needed changes. "The incentive is simply just not there," the analyst notes. "I doubt that Japanese banks are really serious about maximizing profits."

Yet Mr. Porté foresees change—but says that, as always, it is likely that the change process will never be fast enough to satisfy foreigners' demands. But it will be sufficient to keep Japan moving down the right path. "Japan," he reminds us, "has this ability to surprise."

Toward Financial Efficiency

by Li Shan

CHINA HAS ONE of the largest, yet most underutilized, capital stocks in the world. Locked within its banking system is over \$4 trillion of financial assets and over \$500 billion in foreign direct investment. Twenty-some years ago, Deng Xiaoping said, "Finance has to be the heart of a modern economy." Today, the economy may have modernized, but the finance side of the equation is stuck in the past. China's economy sits on a proverbial goldmine of underutilized capital, and its state-controlled financial system is ill-prepared to cope.

The past two decades of growth in China have been driven by a number of fundamental economic reforms: the introduction of competition into the product and labor markets, the deregulation in pricing and resource allocation, the development of a nonstate sector, and the privatization of state-owned enterprises, all of which were catalyzed by an enormous influx of foreign direct investment. Although these have not been easy battles, the real war of economic development in China remains to be waged: It is the fight to promote efficiency in a fledgling financial system that will make or break China's further economic development.

Unfortunately China's current financial system is weak on all fronts. Households and enterprises have few investment options other than putting their savings into domestic commercial banks, which are almost all state-owned. These banks then lend to inefficient SOEs, generating the biggest waste of capital in the economy. Derivatives and other hedging instruments are still largely foreign concepts in China today.

The source of these problems is three-

fold: incomplete financial markets, inefficient financial intermediaries and a nonconvertible currency. First of all, China lacks a complete set of financial markets that would provide its firms with access to a necessary range of debt, equity and derivatives products and enable the creation of a properly balanced capital structure. Commercial banks still dominate the financial system and supply over 90% of the nation's capital today. In contrast, other sources of capital are relatively underdeveloped. In equities, there is a lack of scale and liquidity due to regulatory controls and a dearth of industry expertise. For a country with a GDP expected to be over \$2.6 trillion in 2006, China's total equity market capitalization is only \$600 billion, or less than 25% of its GDP. The difference is alarming when compared with the U.S. at about 120%. Public corporate debt markets, which generally trail the development of equities, are still at a nascent stage, as are the markets for derivatives and commodities.

The resulting capital structure for the typical Chinese firm is overleveraged with bank loans, leading to both overinvestment and underinvestment among borrowers. On the one hand, borrowers are incentivized to pursue high-risk projects,



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since they can keep the upside while letting lenders risk the downside. On the other hand, the same borrowers may not be able to raise new capital to finance worthwhile investments, since the projects' returns will be used to pay back existing lenders before new investors can share the residual upside. Meanwhile, the lack of hedging instruments leaves many Chinese enterprises exposed to interest, currency and commodities risks.

The situation is made worse by the extreme inefficiency of China's financial intermediaries. Financial institutions are primarily state-owned and state-controlled, and most suffer from inefficient organization structure, misaligned management incentives, poor internal controls and antiquated IT systems. China's major banks have collectively made tens of billions of dollars of bad loans to SOEs, while they have neither capability nor incentive to finance robust small- and medium-sized enterprises, most of which are privately owned. As a matter of fact, all four of the major Chinese state-owned banks were technically insolvent before the government injected tens of billions of dollars to restructure their balance sheets in preparation for their respective international IPOs. The situation at domestic securities brokerages is no better and may even be worse. Many of the brokers are insolvent, often due to unprofessional and sometimes illegal business conduct by their government-appointed managers.

Although corporate governance, incentive schemes and technology systems have improved at some of the larger financial institutions (such as Bank of China) as part of their pre-IPO cleanups, the government has still not taken action to upgrade these banks' most important asset—human capital. Ironically, most of the managers who ran these banks into the ground years ago are still at the helm today. It will be in the country's best interest to have

professional managers to captain its financial institutions, although doing so will certainly be against the self-interest of the incumbent management.

The third problem is that Chinese leaders are reluctant to make the yuan fully convertible, because they are rightfully worried about the vulnerability of the country's weak financial system when it is subject to international competition and global financial market fluctuations. However, mounting international pressure aside, it is China that would benefit most from a convertible yuan when the conditions are ripe. Today its domestic enterprises pay a financing penalty to access international capital. As trade volume continues to rise, the yuan has the potential to become a common settlement currency. It goes without saying that for China to become a competitive international financial center, the country will first need a fully convertible currency.

If history is any indication, however, the future is hopeful. The past two decades of successful reform and continued policy commitments inspire confidence. The issues above notwithstanding, China appears to be transforming its financial system, albeit at its own pace. One thing is certain: The financial system will be a completely different landscape in 10 years, from the perspective of both market structure and intermediary institutions.

The expansion in breadth and depth of China's capital markets is inevitable. Start with the fixed-income markets: Efficient pricing across the credit spectrum and diversified investment products in each risk segment will help allocate capital over a broader cross section of the economy. Primary and secondary markets for sovereign, municipal and corporate debt will grow in activity. As the government gains experience in exercising monetary policy and the economy becomes more responsive to market signals, the short-term trea-

sure market will rapidly expand and become a significant policy instrument.

On the equity side, public and private equity will become commonplace. Signs are pointing to the domestic equity markets reaching \$2 trillion in the next five years as companies turn to equity financing at the expense of traditional banks. Closer linkage and possibly some degree of integration between the Chinese and Hong Kong stock exchanges will create a regional trading platform with the liquidity, transparency and regulatory oversight to rival leading global equity markets. In 10 years, the combined market capitalization of China and Hong Kong will most likely become the second largest worldwide, after the U.S. As a result Chinese enterprises will benefit from a more streamlined capital structure with a more optimal debt-to-equity ratio.

At the same time, the derivatives and commodities market will develop to improve the diversity and efficiency of the Chinese financial system. China will become a leading player in both international and domestic commodity markets based on the size and momentum of its economy. Hong Kong has the potential to become China's dominant derivatives center due to the advantages its legal system and human capital have over mainland cities such as Shanghai.

Ten years from now, the landscape of financial institutions in China will also be noticeably different. Through privatizations and restructurings, some of the better-run banks may emerge as world-class institutions. However, many more are destined to fail. Some will disappear and make way for new players, including privately owned and operated banks with international know-how and best-in-class management teams. Domestic securities firms, asset managers and principal investment houses will gain stature as their respective markets expand. A handful of Chinese fi-

nancial institutions may even become international household names, either by growing out of existing franchises in the banking sector or by starting up as green-field ventures in securities and asset management. A homegrown financial giant may be in the making, not unlike the Citigroups and HSBCs of the world. Last but not least, a new class of internationally competitive professional managers will rise to replace the current management among the financial institutions.

Given the above, within 10 years conditions should be ripe for China to make the yuan fully convertible. Already it is a promising start that international lobbying and actual economic needs have moved the currency toward a floating peg. A convertible yuan also has important implications for the Hong Kong dollar. The Basic Law requires the Hong Kong dollar to be pegged to a fully convertible currency. Yet its peg to the U.S. dollar is increasingly irrelevant as the territory's economic and financial interests become more closely aligned with those of China. The logical implication of this is that over time the Hong Kong dollar should shift to a yuan peg. This will be the first step toward what may ultimately be the unification of financial and currency markets across China.

Is this scenario overly optimistic? I don't think so. Social, economic and political challenges persist, but the pieces are in place for a sea change in the Chinese financial system. The parallels between the China of today and the U.S. at the turn of the 20th century suggest that, like the U.S., China will succeed in building a strong financial system.

In the same way that a confluence of geopolitical factors during the turn of the 20th century paved the way for the U.S. to become a global power, history appears to be repeating itself today in China. During the 19th century, the U.S. was a haven for European capital due to its relative cost

advantage, and in the early 20th century it was multinational capital that ushered in the industrial age in the U.S. But in the early 1900s the U.S. had a weak financial system, with no regulatory framework and no central banking institutions—arguably worse than China today. However, America's industrial base ultimately gave the country a voice on the global stage, and paved the way for the rapid development of its financial system.

China is at a similar stage of economic development as the U.S. was a century ago. The country's powerful manufacturing base and significant financial resources (not the least of which is its \$1 trillion in foreign-exchange reserves) have already

created a solid foundation to build an efficient financial system. What is required to take the financial system to the next step is a strong will to succeed, and fortunately the country has no shortage of determination. Recent generations of Chinese leaders have been committed reformers and the current leaders are also paying a great deal of attention to financial reform, as evidenced in the recent international listings of China's largest banks.

Chairman Mao once said: "Ten thousand years is too long; let's get it done in one day." One day is certainly too short, but 10 years may be long enough to build a foundation that will break the state monopoly on China's financial system.

India's Foundation for Growth

by K.V. Kamath

CORPORATE GOVERNANCE IS commonly viewed as a mechanism for the protection of shareholders' interests. Yet corporate governance is about much more than control or protection—it is a mechanism for enhancing the interests of all stakeholders. Good corporate governance practices result in sustainable value creation, and everyone is a winner.

Companies with poor corporate governance are unlikely to be able to compete with those with superior corporate governance practices in the long run. In an increasingly complex business environment, companies need to take into account the conflicting needs of different sets of stakeholders. This is not only limited to shareholders, lenders or depositors, but extends to customers, employees, vendors and regulators, who are also vitally interested in the health of the com-



pany's operations. Corporate governance provides assurance to stakeholders that the company is indeed taking a balanced and holistic view. It reduces the burden on scarce external regulatory and supervisory resources through enhanced self-regulation and monitoring within the company. This reduces systemic risk and positively impacts the overall health of the economy.

India is a good case in point. Good corporate governance standards have been one of the competitive differentiators for India among the emerging market economies. It has been a key to attracting and retaining foreign investment into our equity markets. In 2005, India was ranked third on corporate governance among the Asian economies in a study conducted by CLSA,

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behind Singapore and Hong Kong. This is no small achievement given India's size, diversity and stage of development. This should give great comfort to the investor community that India is indeed on the path of a long period of sustainable economic growth.

Sound corporate governance has been a key to the success of Indian companies. After economic liberalization and the opening up of the economy to global competition in the early 1990s, Indian companies went through a prolonged and often painful process of restructuring and repositioning. However, during this period companies learned the critical importance of operating discipline, financial discipline and efficiency. Businesses changed their mindsets and became much more sensitive to the needs of all their stakeholders. This built a strong foundation on which companies have been able to rapidly grow their businesses as opportunities come along.

In recent times, India has significantly enhanced its corporate-governance framework through new provisions in the listing agreement which cover board composition and procedure, audit committee responsibilities, risk management, CEO/CFO certification of financial statements, internal controls and legal compliance monitoring. The domestic legal, accounting and regulatory framework in India has also been evolving to ensure a sound and sustainable growth platform. The capital-markets regulator has been upgrading disclosure standards for public issuances of equity to international levels. Listed companies are now required to comply with several regulations regarding board composition, financial reporting and status of internal controls and compliance. Indian accounting standards, which are based on the International Financial Reporting Standards, are continuously updated. Regulatory frameworks have also been revamped to incorporate internationally accepted best

practices. For example, the Reserve Bank of India recently announced a roadmap for adopting Base II—a revised regulatory framework for banking. It has also defined several governance principles for banks, including, for example, fit and proper criteria for bank directors.

In the banking sector, corporate governance has a special role. Banks are unique institutions in that they are highly leveraged financial intermediaries who channel public savings into productive investments. They are in the business of risk-taking and there is a time lag between their credit decisions and the results of those credit decisions. They also have a variety of stakeholders with differing objectives—shareholders, depositors, customers, regulators and government. Thus, it is clear that the cost of bad governance in banks is high, as it can lead to systemic crises. A solid governance framework is central to the functioning of any bank.

At ICICI Bank, the establishment of sound governance practices has been central to our philosophy. We separated the positions of chairman and chief executive officer as far back as 1996, created a board with a majority of independent directors, established specialized board committees comprising a majority of independent directors to oversee critical areas, and linked the compensation of fulltime directors, as that of the rest of the organization, to quantitative and qualitative financial and strategic targets. Our board plays a strategic role, with a focus on defining objectives, advising, questioning and evaluating the executive management. Our board supports as well as challenges management. It does this by setting expectations and performance measures and simultaneously providing guidance. At the same time, our board distinguishes between governance and management. The board refrains from micromanagement, letting the management be solely responsible for

day-to-day operations. We believe that this has been a key driver of our growth and performance.

Today, more than at any time in the past, globally there is an increased focus on the issues of governance, accountability and disclosure following a series of corporate scandals. These unfortunate events have been a wake-up call for all the key players in the world of business—companies, investors, governments, regulators and accounting firms. Governments and regulators have responded with legislative

changes of unprecedented depth and breadth. Rather than simply responding to the recurring imposition of new requirements and putting out the next regulatory fire, companies must clearly understand the benefits of good governance. Sound corporate governance practices are a win-win proposition for everyone. They are key for protecting the rights of stakeholders, important for improving market efficiency, crucial for attracting capital and an essential enabler of sustainable value creation.

The Service Heart of Asia

by Jaime Augusto Zobel de Ayala

IN 1995, THERE were 371 million people world-wide aged 65 years old or more. By 2025, this number will more than double, and by 2050 there will be more than 1.4 billion elderly individuals worldwide, most of them in developed countries. The elderly in Europe, North America, Japan and Australia already comprise at least 10% to 15% of the total population, and their share is expected to double in the next 30-35 years. The most rapidly aging countries like Japan, Germany and Italy already have more than 40% of their populations aged 65 years or more. The demands attendant to the graying of the industrialized world are creating tremendous and exciting economic opportunities in the global service economy.



This demographic shift has the potential of creating a demographic dividend for countries with younger populations who are willing to fill the service gap. The Phil-

ippines, with half of its present 85 million population below the age of 21, and with a young labor force projected by a recent Asian Development Bank study to grow from 34 million workers in 2005 to 42 million in 2015 and further to 52 million in 2030, is poised to exploit and benefit from this global business opportunity. I believe this demographic fit of a young, English-language proficient Philippine nation with the large aging and affluent populations in the developed world is a central fact in realizing future Philippine prosperity and transforming the opportunities of globalization into concrete economic reality.

Overseas employment was an early and initially dominant part of Philippine economic engagement with the global service economy. At the end of 2004, the government's Commission on Filipinos Overseas estimates that 8 million Filipinos were living and working abroad, including 3.6 million overseas workers and 3.2 million permanent residents. The top destination countries are Saudi Arabia, United Arab

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Emirates, Taiwan, Japan and Hong Kong, while most permanent residents went to the U.S., Canada, Australia, Japan, the United Kingdom and Guam. The Philippine Central Bank reported that Filipinos overseas remitted \$8.5 billion in 2004, making remittances among the top sources of foreign-exchange revenues of the country.

The 2005 survey of overseas Filipino workers reported a 12.5% increase in total numbers deployed over 2004. The same survey indicated that the largest percentage of overseas Filipino workers in Saudi Arabia, the U.A.E. and Taiwan were in production, transport, and equipment operations, while most workers going to Hong Kong and Japan were service workers and performing artists, respectively. Overseas employment and permanent migration of Filipino workers are likely to continue, but the occupational composition of workers going overseas is going to fit the distinct profile of actual global demand for overseas employment and work-related migration. This mode of global engagement with the service economy is not going to be the only one for the Philippines.

As the industrialized world ages, our young and growing labor force will provide a wider range of important support services both on a remote basis—ranging from answering help-desk calls to calling elderly patients to remind them to take their medication—and in the Philippines—ranging from medical tourism to retirement communities. These will be propelled by the continued decline of telecommunications and travel costs.

As the costs of connectivity, whether for voice or data, continue to decline, enterprises are seeing that virtually any service that can be provided over the phone or the computer can now be provided remotely from countries with large and cost-effective pools of skilled or trainable English speakers such as the Philippines.

As their positive experiences with software programming and call centers result in growing confidence, companies are now experimenting with the next wave of services not previously considered, such as research and analysis for investment banks, contract reviews for law firms, and commercial graphics for printers and advertising agencies.

Telecommunication rates in the Philippines are already competitive from a global perspective. A July 2006 working paper by Galang and Garde for the Asian Institute of Management and the Business Processing Association of the Philippines reports that for companies with high-volume managed voice services, contracts for more than 100,000 minutes per month are available for voice termination to the U.S. for as low as \$0.025 per minute. And increasing demand for long-distance telecommunications services to North America has lowered bandwidth costs by 35% annually in the last five years. Costs to Japan and Europe are also likely to go down as demand increases.

As the costs of travel continue to decline, and the costs of health care and assisted living in the developed world increase, more and more individuals will consider visiting countries like the Philippines for their health-care needs, or relocating permanently to take advantage of gated communities built specifically with the needs of retired foreigners in mind.

The Philippines has quickly become one of the world's top destinations for the business process outsourcing industry, which is estimated to have a global market worth \$422 billion that will grow to \$641 billion by 2009, according to a study by research firm IDC. The Philippines' share of this market has grown to a projected \$3 billion in revenues from over 200,000 workers this year from almost nothing in 2000. Recent projections predict BPO employment to reach 350,000 persons by 2010, generating

\$12.4 billion in export revenues. The BPO sector's export revenues are expected to surpass those of the garment industry by this year, and those of the tourism industry by 2007.

Experts now rank the Philippines among the top four offshore BPO countries (after India, Canada and Ireland), and many have dubbed it the "Call Center Capital of the World." The explosive growth has not been limited to call centers however, as other services such as finance and accounting, medical transcription, software development and animation have also been growing rapidly.

The current dominance of India as the top BPO country is not necessarily a hindrance to Philippine growth in this business. Temporary manpower shortages in India will need to be met by other countries. In addition, the large multinational firms prefer to diversify offshore service locations to ensure continuity by reducing unforeseen risks from having operations in only one country. For companies with BPO exposure in India that is already substantial, the Philippines can be an optimal secondary location.

Companies have been turning to the Philippines for many reasons. Often cited

reasons include the large pool of hard working and skilled college graduates—400,000 graduates per year—and the country's excellent English-language skills. The Philippines is the third-largest English-speaking population in a globalizing world that increasingly uses the language as *lingua franca*.

Also important is Filipinos' deep affinity with Western cultures, which stems partly from its past as a colony of both Spain and the U.S. and partly from a present diaspora that includes Filipino expatriate communities in many Western localities. This affinity makes us particularly well suited to interact with Western customers. And perhaps most important is our people's well known warmth, patience and service orientation, which are all critical ingredients for achieving high levels of customer satisfaction.

For these reasons I expect the Philippines to become a major player in the global services economy. I concur with an observation made by others: China may be the brawn and India the brains of Asia, but the Philippines can well be the heart of Asia. That heart beats strongly and determinedly to realize a much brighter future in the global service economy. ■

Unwiring Asia's Billions

by Joseph Rago

THE THING ABOUT China," says Intel Corp. Chairman Craig Barrett, "is that they've got infinite patience. If you want to know what they're going to look like in 10 years, just look at what they're doing now." Mr. Barrett, the avuncular, 67-year-old chairman of the world's dominant microchip maker, rightly credits technology as a major driver of China's steady expansion, as well as an accelerant for social and cultural standards. He confidently predicts likewise for the rest of East Asia.



One might extrapolate another indicator of Asia's prospects from Mr. Barrett's China quip: If you want to know what the region will look like a decade hence, view it through the aperture of what Intel's doing now. The company, after all, dominates 73% of the microprocessor market, closely monitored by analysts as a gauge of the overall health of the tech sector.

"There's a hotbed of entrepreneurial activity compared to the rest of the planet occurring in Asia right now," Mr. Barrett says. "I expect that to continue." If all this augurs well for a region boiling with consumer and industrial energies, the Intel experience also limns the possibilities, complications and ambiguities of a region opening itself up to the world.

"Half our investment funds are in Asia," Mr. Barrett notes. "Not so long ago, it used to be less than 10%." Asian-Pacific operations (excluding Japan) already contribute 51% of Intel's total revenue.

"Our attitude is, and will be, to chase the best resources, wherever they reside," says Mr. Barrett. When he refers to "re-

sources" he means a basket of interests: not just low labor costs, but also quality of workforce, education, engineering, the total cost of doing business, regulatory regimes, and infrastructure, which includes everything from power to water to lift capacity.

Intel's activities in Asia are not focused solely on manufacturing for foreign markets—only 30% of Intel's revenue comes from the U.S. Indeed, company strategy increasingly hinges on more global ambitions and on emerging markets, the most promising of which are located in Asia.

Mr. Barrett describes Intel's current research and development efforts as focusing on "upping the capabilities of silicon and new computer architectures." This will serve to facilitate "convergence," that is, the coming together of information with the technologies necessary for its dissemination. As to the future of technology in Asia (as elsewhere), Mr. Barrett makes frequent reference to "unwiring," which is the accelerating adoption of broadband and especially wireless technologies. Intel is focused on the chips that embed WiMax technology, a mobile wireless protocol that sends data faster than WiFi (the current regime) but requires fewer antennae and a fraction of the infrastructure of broadband. In the U.S. and some parts of Europe, the adoption of WiMax has been hindered by government administration of the radio spectrum. Mr. Barrett does not anticipate the same rigidities in Asia, and

~ Mr. Rago is an assistant editorial features editor at *The Wall Street Journal* in New York.

Intel is currently testing wireless networks in the Philippines, Thailand, Indonesia and Vietnam.

All of this helps fuel a self-stoking cycle that has been in place for decades: Asian countries acquire Western technology and know-how as Western conglomerates gain access to new markets, and in some sense help create them. Intel also strategically invests in venture capital collaborations with Asian companies to increase integration. Another aspect of this trend is Intel's World Ahead initiative, whereby the company is investing \$1 billion to provide increased access to digital technology and particularly PCs to the world's next one billion new users, many of whom live in developing countries. The program, Barrett says, "looks around the world at the best-known methods and transports those to provincial regions" and connects them, through affordable PCs, to medical, educational and commercial knowledge.

Intel tailors its operations to the capabilities of the country, Mr. Barrett says. China, for instance, has long been a major hub for lower-end manufacturing, with several plants in Shanghai and one that opened this year in Chengdu. By contrast, Intel has centered several design and development facilities in Malaysia on account of the more advanced expertise of the workforce there, investing more than \$3 billion since the 1970s. But none of this is static. Citing China's huge educational infrastructure and relative abundance of engineers, Mr. Barrett notes that more R&D work will be concentrated in the country.

Mr. Barrett is also particularly keen on the future growth potential of Vietnam, where Intel recently announced it would spend \$300 million to build a semiconductor assembly and test facility. Noting 8% to 9% economic growth in recent years in addition to the country's incipient entry into the WTO, he expects the country to emerge as an alternative to China, especially in the

areas in and around Ho Chi Minh City.

Mr. Barrett visits upwards of 30 countries a year, and he has dropped by New York to chair a newly established United Nations committee called the Global Alliance for Information and Communication Technologies, which, as he puts it, exists "to bring information and communication technology to the emerging world." He rolls through a catalog of goals very much in line with those of World Ahead—WiMax connection, local content, knowledge sharing, education. "I think there's a huge opportunity here—it can help in the area of accessibility for the next billion or two billion people around the world who aren't using technology yet but will be.... I look at it as being terribly important."

Juxtaposed with his involvement with the U.N., however, is Mr. Barrett's belief that elements such as free society or freedom of expression are relatively less important preconditions for creativity and innovation in Asia. "The quality of education and the quality of the work force," he emphasizes again, "are probably the most serious. Rule of law and protection of intellectual property are critical...."

"I'm not necessarily sure how you define 'freedom of society'—not sure it's a good metric by which to judge the quality of the engineering, the quality of the work force. Interestingly, for example, because Russia was a relatively closed society [during the Cold War], they didn't have access to hardware. Correspondingly they had to compensate by developing great expertise in other areas—so the software and applied mathematics capabilities of Russian scientists today is probably second to none—perhaps driven by a closed society. So it can act in perverse ways."

Intel, of course, makes hardware, and most of the Asian controversies have turned on software—for example censorship issues related to the Internet, particularly in China and Singapore. While Mr.

Barrett is quick to draw this distinction between hard and soft, he is also plain: "We've always looked at the Internet as an information source and as such it follows the fax machine, and CNN, and so forth, as a great democratizing influence—essentially real time, any place, anyone."

Mr. Barrett's basic proposals for Asian countries to spur innovation and creativity are concise. "Three things," he says. "One, continue to drive their education systems. Second is government-sponsored research and development into basic linchpins of creativity. Entrepreneurialism is basically smart people, smart ideas. Third, the government has to set the environment for the combination of those first two, the sort of activities that encourage investment and

innovation—that's the rules, regulations, tax policies, the presence of venture capital." Then other issues, perhaps, will resolve themselves of their own accord. The Chinese Communist Party, for instance, has loosened its grip, from managing every facet of its citizens' daily lives 20 years ago, to concentrating on controlling the media and political opposition today. And even here, Mr. Barrett suggests, the state's attempt to fence off political reform from an emerging neoliberal market economy is unlikely to succeed.

Ultimately, expect Intel's preponderance in Asia to increase, not diminish, in the coming decade. And, bound up in that, expect Asia's preponderance in the world to do the same.

The Coming Era of Asian Innovation

by Stan Shih

IN THE PAST, Asia has been a manufacturing stronghold that has led the world's economic growth and prosperity. Specifically, the capabilities in Mainland China's hardware manufacturing and India's software design for original equipment manufacture are continuing to gain strength. Attention on the original four East Asian Tigers (Singapore, Hong Kong, Taiwan and South Korea) has now shifted to China and India, which are experiencing rapid economic transformation and have the potential to become the next fast-growing consumer markets.

High-tech innovation was previously led by economically advanced nations such as Europe, the U.S. and Japan. But in future the application of high-tech innovations will become more widespread, for example by becoming more affordable for lower-income consumers. I believe Asian

companies can play a key role in realizing this.

Asia has already built up a solid foundation in high technology. If Asian companies are able to leverage this solid base and strength, they have the opportunity to lead in innovation and contribute further to the global marketplace. Innovation is not just about new ideas. The key is to commercialize the idea and create added value. Asian companies currently lead in semiconductors and TFT-LCD panel innovation, while India plays a significant role in software design. These are key elements for advancing the digital era.

Asian companies need to take advantage of the opportunities provided by the Asian market and multinational compa-

Mr. Shih is chairman and founder of iD Soft-Capital Group and founder of Acer Inc.

nies' global marketing know-how in order to build up their competitiveness. Market demand initiates the desire for innovation, but innovation poses risks. Hence, a substantial market size is required to drive innovation. To innovate, you must understand market needs and reach out to the market through a brand name. Letting innovation and the brand benefit each other mutually is the direction Asian high-tech industry should take.

Asia has numerous original equipment manufacturers and original design manufacturers, but these companies do not have direct contact with market applications. This means that Asian innovations are mainly technically-based rather than market-based. Understanding market requirements has largely been the responsibility of multinational brands. In the future, as the Asian market continues to grow in scale, market conditions will be-



come more favorable for fostering Asian brands and for building market innovations. Asian companies should accumulate experience and rely on their home market as a basis from which to penetrate the international marketplace.

Historically, Asia's economic development has been stimulated by its manufacturing sector. But in the future, it is market know-how that will be key. Asian companies need to enhance their research and development capabilities and focus on developing innovations that are truly customer-oriented. If they can assess and respond to market requirements, then they will gain the opportunity to play a role in leading global technology innovation. Asian companies already have a solid foundation, but now they need to understand market conditions. Once they do, the high-tech world could usher in an era of Asian innovation.

Building Asian Brands

by Zhang Ruimin

COMPARED TO THE West, Asian brands are somewhat inferior. On the whole, Asia's enterprises are still at an early stage of development, many of them relying on original equipment manufacturing to eek out slim profits on goods processing. In the global market, it is extremely difficult to eliminate consumers' impression that Asian products are inferior to others. As a result, when Asian companies (except for the Japanese), start along the path from "Made in Asia" to an "Asian brand," the first steps are the most difficult. In fact, Chinese enterprises are also at a strategic turning point, from competition between products and markets, to brand-name competition. If these compa-

nies cannot enter the brand-name level of competition they will ultimately lose their opportunity to compete.

According to numbers from the American Marketing Association, nonbrand-name products earn a gross profit of 19% on average, compared to brand-name products which earn an average gross profit of 27%. Due to excessively low profits, the total combined profit of the top 100 companies that manufacture OEM products in the greater Asian region is only \$4 billion. This still does not take into account intangible differences: brand-name prod-

~ Mr. Zhang is chairman of the board and CEO of the Haier Group. Translation by Leslie Hook.

ucts have more power to influence the market, more opportunities for strategic alliances, etc. Compared to the dog-eat-dog competition of the OEM business, brand-name businesses have more control of their own fate. If the owner of a brand-name business finds a new location where costs of production are lower, then it's difficult for the OEM producers to survive. Since OEM production is hard work and the goods can only be sold for slightly more than the cost of the materials, then why not jump into the brand-name market, where prices are higher? In fact, everyone would like to do this. However, it is difficult to succeed because although the brand-name business appears to be selling a product, it is essentially selling a reputation, and reputation must be accumulated over the long term—there's no one step to success.

The most basic prerequisites for becoming a brand-name are to be differentiated from other businesses in the same sector, and to provide consumers with superior service. Like Japan in the '70s and '80s, by promoting all-round quality control, creating a unique enterprise culture, making products competitive with foreign counterparts, and wooing global consumers, companies can rise up through hard work as a global brand.

However, when Asians talk about entrepreneurship the first word out of their mouths is money, whereas in the West the first thing people think of is discovering new products. At the present moment Chinese enterprises are hard-pressed to create a culture of innovation. Firstly they are relatively young and need to digest and absorb the introduction of new technologies; secondly the atmosphere of the market can be described as, "Success in the domestic market, failure in the global market." Be-



fore joining the WTO, competitors on the Chinese market were primarily domestic companies. Because of increased market resources and more space, even companies that didn't innovate could easily exist and even grow. But with the tide of globalization, Chinese companies appear to be weak: Many companies don't even think about brand-creation, and for some it has become difficult to eke out an existence at all.

Of course this does not imply that Asian companies have got no chance and will always be relegated to OEM. We are latecomers and have lost many opportunities, but we also have less baggage and the relative advantages of a late-bloomer. The key is whether or not we have the spirit of innovation, and whether we can discover and take advantage of favorable circumstances for innovation.

This is just like Haier's global branding strategy. Although the differences between us and other multinational corporations are easy to see, we use product differentiation to break down barriers, enter international niche markets, expand and enter foreign markets, and market mainstream goods. We have taken advantage of the information age, which presents opportunities otherwise hard to come by. Therefore Haier is currently concentrating on using technological processes for continued innovation, and is working to use an increasing flat organizational structure to make an organization without boundaries, and enable every staff member face the global market as a strategic business unit. This way we can make everyone a source of innovation: No matter where in the world they are they can be the first to find out customers' needs and respond the most quickly, continuously using innovation to create new customers. ■



REVIEWS



IN THE LINE OF FIRE: A MEMOIR

by Pervez Musharraf

Free Press, 368 pages, \$28

Reviewed by SADANAND DHUME

ON SEPT. 19, 2001, as the ashes of the World Trade Center still smoldered, a shaken Gen. Pervez Musharraf went on national television and radio to explain an unpopular decision to his countrymen. He had agreed, under intense American pressure, to throw Pakistan's support behind the effort to crush the Taliban, al Qaeda's Afghan host.

The decision was understandably painful given the Taliban's birth in Pakistan's fundamentalist *madrassas*, its nurture by the country's premier intelligence agency, Inter-Services Intelligence, and Islamabad's long and lonely effort to win international recognition for the bearded rulers of Kabul. Gen. Musharraf sold it by drawing a parallel with an event obscure to non-Muslims but rich with meaning for the faithful: the Treaty of Hudaibiya (628 A.D.), a 10-year truce between the Prophet Muhammad and the then infidel but powerful tribe of Mecca, the Quraish. Two years later a much stronger Mohammed found a pretext to break the pact, leading the Quraish to surrender Mecca without a fight. In the Muslim imagination, Hudaibiya stands as an example of a tactical compromise with an enemy in the interests of a broader strategic gain.

This detail would be merely academic if not for the fact that five years after Gen.

Musharraf's speech his commitment to the war on terror remains questionable to say the least. From last year's suicide bombings in London, to this summer's Heathrow Airport bomb plot, to stepped-up attacks on NATO forces in Afghanistan, the trail invariably leads back to Pakistan. Add to that evidence of Islamabad's complicity in the July train blasts in Mumbai and in supplying nuclear technology to North Korea, and it's easy to see why historian Niall Ferguson sees the danger of another Sept. 11 style attack coming less from the so-called "axis of evil" than from the "axis of allies": the Saudis who fund terrorism; the Pakistanis who provide the training; and the British, whose laissez-faire approach to radical Islam has helped create the plotter's haven known as Londonistan.

Those expecting *In the Line of Fire*, the general's much hyped memoir, to show evidence that Pakistan is grappling with its problems will be disappointed. Instead we're treated to an unintentionally amusing portrait of a man who lends new meaning to the old saw about a book only a mother could love. No detail is too small for the pistol-packing (Glock 17) Gen. Musharraf to boast about. Thus we learn that at college in Lahore he was the fourth-best cross-country runner, stood third in the "Mr. Forman Christian College" bodybuilding competition, and that one Muhammad Iqbal Butt, a former Mr. Universe contestant no less, complimented the future leader on his "most muscular physique."

Mr. Butt ought to feel honored, for most of Gen. Musharraf's encomiums are self-generated. At the Pakistan Military Academy, his physical bearing and drill

∞ Mr. Dhume is a Bernard Schwartz fellow at the Asia Society in Washington, D.C.

are "so good" that he passes his saluting test on the first try. In short order he becomes "an exceptionally good shot with a rifle and a submachine gun." His men, of course, love him for being "just and compassionate." Years later, after the general has seized power from the country's elected prime minister, Nawaz Sharif, in what he imaginatively calls a counter-coup, he even manages to claim credit for allowing the army's powerful corps commanders to have their say at a meeting to discuss the possible imposition of martial law. For the general this is "normal practice," we are informed, though such enlightenment is apparently "new to the army."

The barrage of self-congratulation is laced with an unctuous effort to ingratiate himself with the Western reader, or perhaps prove he is no fundamentalist. We learn, for example, that as a child the general owned a brown dog named Whiskey, and that while his father was posted at the Pakistani embassy in Ankara in the 1950s his parents won first prize in a ballroom dancing competition to celebrate the coronation of Queen Elizabeth II.

The attempts to incorporate American metaphors are especially strained. Gen. Musharraf the boy is "something of a Tom Sawyer." Nazimabad, the low rent neighborhood where the family alights as refugees from Delhi in 1947, is not "the Harlem of Karachi," but perhaps "the South Bronx." The mullahs who keep Pakistan on the cutting edge of obscurantism are called "the religious right." Not to be outdone, his wife-to-be, Sehba, miraculously prefigures today's People magazine terminology in 1960s Karachi: At first she is appalled by the "fashion disaster" who seeks her hand.

Unintentional humor aside, *In the Line of Fire* reveals two disquieting aspects of Gen. Musharraf's personality. The first is a kind of back-alley cunning easily recognizable to anyone who has lived in a coun-

try where bribing the meter reader is an acceptable alternative to paying the power company. Gen. Musharraf boasts of "out-smarting" hazers as a young cadet by hiding in the bathroom while his classmates balance tubs of ice cold water on their heads or crawl on all fours. Later he risks expulsion from the academy when caught taking a shortcut during a nine-mile punishment run. As army chief in the summer of 1999, Gen. Musharraf surreptitiously sends soldiers across the line of control that divides Indian and Pakistani Kashmir to capture a clutch of strategic heights. He describes the resulting miniwar, by most accounts a diplomatic and military debacle for Pakistan, as "a tactical marvel of military professionalism."

More disturbing is his ambivalence toward combating fundamentalism. Gen. Musharraf criticizes former Prime Minister Zulfikar Ali Bhutto not for appeasing "the religious right" by banning liquor and gambling and declaring Friday a holiday instead of Sunday, but for doing so without really believing in it. Yet he comes to the decision to join the war on terror only after "wargaming the U.S. as an adversary." Only then Deputy Secretary of State Richard Armitage's alleged threat to bomb Pakistan "back into the Stone Age" prompts him to abandon the Taliban. "Why should we put our national interest on the line for a primitive regime that would be defeated?"

This ambivalence shows up in other ways as well. On the one hand Gen. Musharraf boasts of handing over 369 al Qaeda operatives to America and earning millions of dollars in bounties. On the other, rather than ask uncomfortable questions about his own society, he casually blames murdered Wall Street Journal reporter Daniel Pearl for being careless. He also displays a grudging admiration for Khalid Sheikh Mohammed: "One cannot say that KSM did not have big plans, the big-

Gen. Musharraf displays a disquieting back-alley cunning and an ambivalence toward combating fundamentalism.

gest of which, 9/11, was carried out with clockwork precision.”

In a similar vein, the book offers an apologetic for Osama bin Laden by referring to the jihad consortium he established in 1998 as the “Islamic World Front” rather than using its rather less innocuous formal name, the “Islamic World Front for the Struggle against Jews and Crusaders.” In Gen. Musharraf’s formulation, the Front is formed merely to “struggle against the occupation of Palestine by Israel.” He repeatedly blames the West for terrorism, arguing that it will only end when “injustices against Muslims are removed,” and claiming that since the July 7 bombers in London were not politically deprived, uneducated or poor, “clearly, their motivation came from the socioeconomic deprivation of their community.”

Ever since Sept. 11, Gen. Musharraf has successfully packaged himself as Pakistan’s last line of defense against radical Islam, a no-nonsense, straight-shooting military man who can be relied on to get the job done. But with attacks on NATO troops in Afghanistan from their Pakistani sanctuaries mounting, and bin Laden, Ayman al-Zawahiri and Mullah Omar still at large, he will need to do more to prove his sincerity than plucking the occasional unfortunate off his country’s endless terrorist assembly line.

Shedding the odd blend of victimhood and triumphalism that marks much of the Muslim world, and shutting down the madrassas that fuel jihads in Afghanistan and India would be as good a place to start as any. Until then skeptics will continue to argue that Pakistan’s half-hearted effort in the war on terror is marked by do-the-minimum convenience rather than any real commitment.

THE LENOVO AFFAIR: THE GROWTH OF CHINA’S COMPUTER GIANT AND ITS TAKEOVER OF IBM-PC

by Ling Zhijun,

translated by Martha Avery

John Wiley & Sons, 250 pages, \$24.95

Reviewed by RICK CAREW

CHINA’S CORPORATE strategy over the next five years will be centered on two key objectives: scaling the value chain and creating global brands. These goals, while government-supported, are driven largely by economic fundamentals. As wages rise, China’s coastline can no longer afford to be a low-cost manufacturing center. At the same time, China’s policy of openness to trade and investment has created a hypercompetitive domestic market that offers scale but low profits to firms that can’t distinguish themselves by building a brand.

These market realities put Chinese firms at a disadvantage vis-à-vis global multinationals. Few Chinese companies possess superior branding and most have relied on their ability to undercut global competitors on price to stay competitive at home. But multinationals that once saw China as solely a cheap manufacturing base are now turning their attention to its increasingly affluent consumers.

To address these challenges, Beijing has advocated a dual strategy of “going outward” and creating an “innovative society.” Chinese firms must look abroad for investment opportunities that will build their brands and pack more value into their products at home.

∞ *Mr. Carew is a Beijing-based correspondent with Dow Jones Newswires.*

From this view, a history of Lenovo would seem to be a textbook for how Chinese firms can remold themselves to become more competitive. The state-owned firm's acquisition of IBM's personal computer unit in May 2005 marked the first major Chinese buy of a respected U.S. brand and a key innovator to boot—IBM having invented the personal computer.

This new book by Chinese journalist Ling Zhijun offers a compelling and detailed account of how a few practically minded government scientists co-opted a guardhouse from their research institute and turned it into the world's third-largest personal computer firm behind Dell and Hewlett-Packard. However, the account also shows how Lenovo's success derived mainly from its ability to imitate and market products rather than innovate.

The company launched with an ill-fated effort to resell color television sets in 1985, eventually establishing itself as a key agent selling IBM computers on the mainland. Like many upstart companies at the time, Lenovo didn't actually make computers. Instead it exploited shortages created by China's import-quota system to buy computers from those with unused quotas and then resell them at higher market prices. Its only major value-added component was a device called the "Han-card" that allowed the computer to accept Chinese characters, one of a slew of similar Chinese-input products at the time.

Lenovo made use of its roots as a salesman for IBM and other Western computing giants when it made its first major splash by marketing low-end computers under its own name brand in the early 1990s. "Since

we are a Chinese brand, we don't want to position ourselves as a kind of Cadillac," Yang Yuanqing, the company's future chairman, said in 1994. "If you are going to be making computers for China's 300 million households, then you have to make them appropriate to the purchasing power."

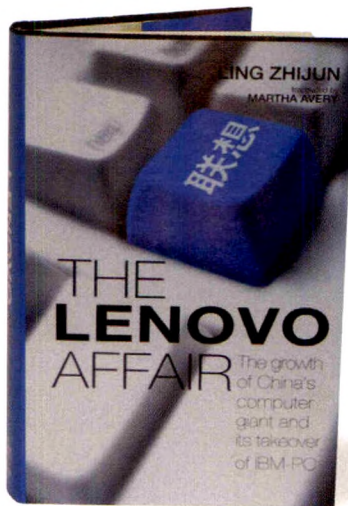
The company's experience in marketing also helped its management steer the company away from expensive innova-

tive ideas cooked up by Lenovo's scientists in the mid-1990s. The Lenovo founder who helped invent the "Han-card" for inputting Chinese characters tried to push the company to compete with Intel in developing central processing units, the most sophisticated component of a PC. The plan was obviously well beyond the firm's technological and financial reach—its most sophisticated product at the time

was motherboards, the most basic of computing components.

Those two key turning points in the company's history carry a valuable lesson for Chinese companies today: start at the low end of the value chain and rise cautiously. They also show that Chinese firms will need to master marketing techniques to compete successfully on their home turf. Lenovo's ruthless cost-cutting allowed it to weather price wars and watch as domestic rivals were crushed under mounting competition from better-capitalized foreign firms.

Meanwhile, Lenovo made a key play to position itself as a "national brand," securing government support in the form of tax breaks and state help in key strategic ventures, including approval for the IBM takeover. While other domestic computer



Lenovo's history would seem to be a textbook for how Chinese firms can become more competitive.

makers (whose names have been forgotten) paired up with foreign competitors, Lenovo wrapped itself in the Chinese flag. "If we too were to give up the *Lianxiang* [Lenovo's name in Chinese] brand of computers, then it is very likely no China-made computers would survive," Lenovo's chairman Liu Chuanzhi said. This was a practical marketing tactic: The reality was that Lenovo's parts, from processors to packaging, came mostly from countries other than China.

This account of Lenovo navigating the gray areas of China's sometimes bizarre business world over the past 20 years is filled with intrigue, corporate politics and fly-on-the-wall reporting. It makes the book a valuable case study of the corporate reforms that have taken place in China. However, by far the most disappointing feature of this book is its scant treatment of Lenovo's takeover of IBM—the event that will probably prompt most readers to pick up the book. The author fills pages with dense accounts of company meetings in the 1980s, but could have served his readers better by providing a forward-looking chapter on future prospects for the company and more juicy details from the IBM takeover negotiations from his excellent sourcing.

Lenovo's most recent results point to the company continuing to eke out slim profits. It earned \$5 million on revenues of \$3.5 billion in the quarter ending June 30, 2006, as it built market share at home and showed moderate success in cutting costs at the acquired IBM unit.

Lenovo's future success is far from guaranteed, but if history is any guide then China's flagship computer firm is likely to continue steadily moving up the value chain and seizing market share. China's next generation of high-tech entrepreneurs will continue to look at Lenovo as a guidepost

to measure their success against. Almost certainly these entrepreneurs, sitting in the research parks set up by Microsoft and Google in Beijing, will find reassurance in the success that followed the risks Lenovo's founders took as they left the comforts of the Chinese Academy of Science just down the street.

**IN SPITE OF THE GODS: THE STRANGE
RISE OF MODERN INDIA**

by Edward Luce

Little, Brown, 400 pages, £20

Reviewed by ED LANE

IN HIS FOUR years in India as bureau chief for the Financial Times and one extra year focused on the book, Edward Luce has made the most of his time. He sponged up vast knowledge of the country and the region, met a major cross section of people, and worked diligently to bring it all into a coherent narrative. For those reasons alone, *In Spite of the Gods* is a good read.

Mr. Luce has definitely formed strong opinions about the country. But he repeatedly tries to leaven his harshest observation: that India's elite and the elected government don't have any sense of urgency about the plight of hundreds of millions of Indians living in poverty. Instead Mr. Luce shows both the good and the bad, and tries to be balanced.

Mr. Luce clearly wants India to prosper and he gives great examples of people in the country who do so splendidly. The problem

∞ Mr. Lane has reported from South Asia for the past decade.

is that the people running the show, with very few exceptions, are not remotely on the same page. He points this out in a variety of ways, from caste-based politics to the sheer venality of local officials who are supposed to provide services to the poor. The harshest example is the story of Hindu mobs who slaughtered Muslims in the Indian state of Gujarat in 2002 as the Hindu nationalist government stood aside to let it happen.

In other ways, he goes to great lengths to tell you why the country may be poised for major leaps: fast growing GDP, smart people and good schools, among other islands of excellence. But it is disconcerting to hear this while he simultaneously points out that common sense administrative reforms are highly unlikely.

The resulting *mélange* juxtaposes examples of incredible callousness with stories of the people who are doing something about it. Because of the numbers involved, however, these sources of hope are just a small drop in the ocean. It is possible that Mr. Luce could have taken a much more direct and angry tone about what he clearly sees as a lack of urgent effort by India's elite to better the lives of the 300 to 600 million people living in poverty in India and set an example for the world.

Mr. Luce discusses coalition politics in some detail, though some of his policy suggestions don't square with the realities of coalition government. India, he notes, will be run by hydra-headed coalition governments for the foreseeable future. But his proposals about creating a unified Ministry of Energy by combining the petroleum, coal and power portfolios or freezing out

parties with right-wing agendas would only make it that much more difficult to bring parties into the cabinet, and are thus unlikely to succeed.

The history of India since independence is well presented for the most part and it provides a good segue into understanding how the country developed. However in some cases he fails to bring into clarity what has become an ongoing battle be-

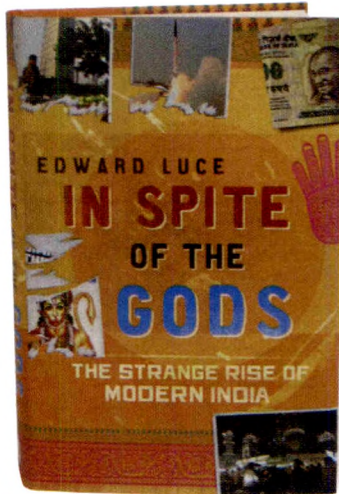
tween the revisionist school of thought and the "we built the railroads and taught English" school about the impact of British colonial rule.

Maybe there's no way to square the legacy of British India's good with the famous "crawling order" by Gen. Reginald Dyer, who forced Indians to crawl on the ground where a British woman's modesty had been compromised, and who is also known as the "Butcher of Amritsar" for ordering

troops to massacre unarmed political protestors in the northern Indian city. To be sure, this debate will never be settled and is largely an academic and nationalistic issue. Mr. Luce doesn't defend the Raj so much as tiptoe around the period.

In another section on the country's nuclear tests and the subsequent diplomatic moves to bring India into the fold of emerging superpowers, the analysis is impressive and worth reading for its glimpses of high-level geopolitics and the economic consequences. Mr. Luce, a former speech writer for U.S. Secretary of the Treasury Lawrence Summers and now Washington commentator for the *Financial Times*, is clearly in his element here.

On point to quibble with is India's record on nuclear material. It's a common refrain in the country that "India is a



India's elite romanticize village life in order to preserve a link to the past and to keep the hordes out of urban centers.

responsible nuclear power" and has an "impeccable" record on nonproliferation unlike neighboring Pakistan. That rhetoric has been endorsed by the Bush administration as part of a landmark deal that will lift sanctions on India imposed after nuclear tests in 1974 and 1998 and allow the country to trade in civilian nuclear technology. The problem is that India accepted a nuclear reactor from Canada, the Candu, that was supposed to be dedicated to research but instead formed the basis of its first "peaceful" nuclear test, and the design was copied to produce more fuel. By any stretch of the imagination, that's proliferation.

Where Mr. Luce gets steam going is on how the economic boom will impact what has become in India the future the country's tens of thousands of villages where daily life is excruciatingly hard for most. India's village lifestyle is romanticized by the elite who want to preserve the outposts as a link to the country's ancient culture or more cynically, keep the hordes out of the already creaking urban centers.

As a great example, he shows how a new affluence in India is making it possible for families in urban areas to increasingly go for low-cost sex determination tests during pregnancy. They choose to abort female fetuses as males are preferred, and this trend gets copied in the villages.

The grim facts of life for many in India, however, don't take away from the hope and fascination of what will happen to a country where almost half of the population of 1.1 billion is below 25 years old. Any anecdote about India—meeting people, taking the train, being invited for dinner or into a village home—would give even the most skeptical person hope. Mr. Luce highlights that well, but where the book

hits home is in the harder observations. In writing about his affection and joy at discovering the many layers of Indian society, Mr. Luce may have partly diminished the critiques he expresses in other sections of the book, like the following:

"As the joke goes, India never misses an opportunity to miss an opportunity. It is also suffering from a premature spirit of triumphalism, believing it is destined to achieve greatness in the 21st century without having to do very much to assist the process."

**USELESS TO THE STATE:
"SOCIAL PROBLEMS" AND
SOCIAL ENGINEERING IN
NATIONALIST NANJING, 1927-1937**
by Zwia Lipkin
Harvard University Press,
424 pages, \$49.95

Reviewed by JONATHAN FENBY

THOUGH NANJING WAS China's capital for a decade from 1927-37, the city did not have an easy a time of it during the Republican era. Declared capital after the overthrow of the Qing Empire in 1911, it quickly lost that title to Beijing when Sun Yat-sen willingly ceded the presidency to the military autocrat Yuan Shikai in 1912. In 1927, it was the scene of an attack on foreigners that severely embarrassed the Nationalists,

Mr. Fenby is author of several books, including *Generalissimo: Chiang Kai-shek and the China He Lost*, and is currently working on the *Penguin History of Modern China*.

who were in the process of establishing themselves as the central government with Nanjing as their new capital. It then twice came under attack from warlord forces and in 1932 was shelled from the Yangtze River by the Japanese. In 1937, after the Nationalists abandoned the city for Wuhan in the face of Japan's advance, the city experienced the infamous Rape of Nanjing, whose fallout continues to mar Sino-Japanese relations to this day. Finally, Nanjing was the seat of the government of Wang Jingwei, which was collaborating with Japan.

However, for the period following the Nationalists' victory in the Northern Expeditions of 1927-28 and their victory over northern opponents in 1930, this one-time imperial summer capital became the model for China's urban modernization. Unlike the Communists, the Kuomintang Nationalists were essentially urban. Chiang Kai-shek came from a village in Zhejiang province, but his core followers were from towns and cities. The Nationalists saw urban development as a key to the future, egged on by their founder Sun's vision of a China "industrialized and internationalized through the mediation of the state."

Nanjing lay at the heart of such plans: It was to become a world city as great as, if not greater than New York or London. Foreign advisers poured in, new buildings and roads were constructed, and committees laid out grand plans for the capital that would be replicated in other cities across the nation. The city's inhabitants were to serve the state as part of its modernization process. Those who did not were of no use and should undergo reform until they could join China's modernization. Ms. Lipkin's fascinating book is focused on the people who were marginalized by the Nationalists' urban modernization process: the rickshaw pullers, shantytown dwellers, beggars and prostitutes.

If it did no more than lay out fresh infor-

mation on the underclass, this book would be a valuable addition to the growing literature that deals with the reality of the Nationalist period in all its contradictions, as against the monochrome picture painted by Communist history and the portrait of doom and decay prevalent in much previous Western writing. But while producing a cornucopia of new information on the classes who give the book its name, the author goes beyond the core subject to show the achievements and limits of the Nationalist urban modernizing drive.

On the one hand was slum clearance, which was undoubtedly valuable; on the other the attempt to ban prostitution, which flopped. The first was seen to be needed, the second was not. Rickshaws might be regarded as unsuitable for a city which should have modern public transport, but they were simply too useful to be done away with—the average number of rickshaws was one-third higher in 1934-35 than in 1928.

Thus the limits of modernization were set by society. As Chiang Kai-shek found, issuing an order was not enough: There had to be both respect and acceptance if it was to be carried out. How far the same applies today is a key question for the current Communist leadership in the capital the Nationalists quit for Nanjing in 1927.

Ms. Lipkin is emphatically not allied with those who see the Nanjing Decade of 1927-37 as a lost time for China when the weakness of the central government, recurrent regional revolts, pressure from the Japanese, inefficiency and corruption undermined the building of a modern state. Concentrating on Nanjing, the author sees it as a success that left long-lasting effects: "The goals of material 'modernization' that the Nationalists began promoting during the Nanjing Decade in Nanjing and elsewhere continued to inspire later regimes and irrevocably transformed the Chinese landscape." Thus, a line is drawn in the

Watch India, and the Indians: Their influence may counterbalance economic and political domination by China.

useful epilogue to the present through “nationalist ideology intermingled with social-Darwinian concerns.”

There is undoubtedly truth in this, at least in retrospect. But, as so often in dealing with revisionist accounts that paint the Nanjing Decade in a more positive light than before, one has to keep scale in mind. What was done in Nanjing was not widely applied elsewhere, as the author acknowledges. For all the Nationalist plans, the central government's sway was weak outside its lower Yangtze heartland, and even there the bigger city of Shanghai went its own way. The “useless” people of China were not reformed by Nanjing's example. The decline of the Nationalist state combined with the terrible impact of the Japanese invasion after 1937 and then the long Maoist era ensured that real modernization would have to wait half a century more, and even then would entail all the uncertainties and fractures one sees today.

INDIA-ASEAN ECONOMIC RELATIONS: MEETING THE CHALLENGES OF GLOBALIZATION

by Nagesh Kumar, Rahul Sen and Mukul Asher (editors)

*Institute of Southeast Asian Studies,
Singapore, and Research and Information
System for Developing Countries,
New Delhi, 313 pages, \$25*

Reviewed by BERTIL LINTNER

FOR YEARS INDIA has been stifled by outdated laws, trade restrictions and a burgeoning bureaucracy. But in 1991, India adopted a package of reforms “to deepen the integration with

the world economy,” as the authors point out in the introduction to this collection of papers. At about the same time, India launched its “Look East Policy” with the aim of increasing trade and economic cooperation, primarily with the dynamic economies of the Association of Southeast Asian Nations.

To discuss these matters the Institute of Southeast Asian Studies organized the Asean-India Forum in Singapore in February 2004. The papers presented at this conference have been revised, updated, and published together to produce a comprehensive overview of India-Asean trade relations.

Two papers look at India's and Asean's respective macroeconomic performance and other sections deal with intraregional trade and the approach to the World Trade Organization, foreign direct investment in Asean and India, subregional cooperation and, finally, a very optimistic scenario for longer-term partnership between India and Asean. The editors are leading experts on these issues: Nagesh Kumar of Research and Development Systems for Developing Countries, New Delhi; Rahul Sen of Singapore's ISEAS; and Mukul Asher, a professor at the National University of Singapore.

The editors state that, “the emerging partnership between India and Asean can be taken forward for mutual benefit, so that the two sides can leverage on each other's strength to better negotiate the forces of globalization.” It is undeniable that trade between India and the now 10 members of Asean has grown rapidly over the past decade. Between 1991-92 and 2003-04, India's exports to Asean in-

∞ *Mr. Lintner is a journalist based in Thailand.*

creased more than five times to \$5.7 billion from \$1 billion while its imports from Asean increased nearly seven times to \$7 billion from \$1.3 billion during the same period. The aim, the authors say, is to “increase merchandise trade between India and Asean to \$30 billion by 2007.”

These figures are no doubt impressive and indicate a trend, but they are dwarfed by Asean’s much more remarkable trade relations with China. In 2005 the two-way trade between China and Asean reached \$120 billion, and the target is to increase this to \$200 billion by 2010. In July 2005 China and Asean also agreed to “gradually cut and even remove duties on more than 7,445 kinds of products,” according to Japan’s Kyodo news agency.

Even Australia is currently a more important trading partner to Asean than India. In 2005, Australia’s merchandise trade with the bloc totaled \$33.3 billion, with exports to Asean around \$12.1 billion and imports over \$21.2 billion.

Compared with China, India is clearly at a serious disadvantage in trade relations with Asean. For decades, trade in commerce in most Asean countries has been in the hands of ethnic Chinese who, even during the darkest periods of strict communism in China, maintained links with relatives and associates in their ancestral towns and villages. When China liberalized its economy following Deng Xiaoping’s reforms in the 1980s, these “bamboo networks” fuelled China’s economy and vice versa, as Murray Weidenbaum and Samuel Hughes described in their 1996 study of overseas Chinese tycoons. While there are fairly well-established ethnic Indian business communities in Singapore, Malaysia and even in Thailand, they are nowhere as big, rich and powerful as the ethnic Chinese equivalents in those countries.

Looking at the future, Mr. Kumar refers to Indian Prime Minister Manmohan Singh’s making a case for “an Asian

Economic Community combining Japan, Asean countries, China, India and South Korea as an ‘arc of advantage’ across which there will be large-scale movement of people, capital, ideas and creativity.” A grand plan, but wishful thinking, others would argue. India’s economic miracle is real but it is also highly specialized in IT services, outsourcing and similar areas. Unlike China, India is not a major exporter of consumer goods, and the down-to-earth business networks are just not there.

That said, India is likely to become a major player in several Asean countries, but not in terms of the economic integration that the authors of this book envisage. Baladas Ghoshal, an Indian professor who has studied the same issues, argues that India’s influence in Southeast Asia is more likely to be not in terms of trade but in the fields of culture and decision-making. Buddhism and even Islam were introduced to Southeast Asia from India, and most Southeast Asian languages are riddled with loanwords from Sanskrit and Pali. This could lead to increased Southeast Asian tourism to India and perhaps other cultural exchanges as well.

More important, however, is the fact that Indians form an extremely successful immigrant community in the United States. Most big American corporations, whether in computer technology, banking or general trade, are likely to have several ethnic Indian professionals in managerial positions, and many of them are returning to Asia as executives for American companies. Although their loyalties lie mainly with their new homeland, this trend still means that India, or Indians, will be a factor to be reckoned with in Southeast Asia. And for supporters of more democratic forms of governments and more modern business practices, that is not bad news.

Despite its shortcomings, this is an important book that looks at a completely new phenomenon in Asia. China is no

Hong Kong's Central District of 60 years ago appears to present-day eyes curiously depopulated, almost a ghost town.

longer the only economic superpower in the region. Watch India, and the Indians: Their influence may be needed to counter-balance economic, and perhaps also political, domination by China.

HEDDA MORRISON'S HONG KONG: PHOTOGRAPHS AND IMPRESSIONS 1946-47

by Edward Stokes

*Hong Kong University Press, 282 pages,
HK\$380*

Reviewed by HUGO RESTALL

WHEN HEDDA MORRISON disembarked from the steamship *Hanyang* in Victoria Harbour on Sept. 21, 1946, Hong Kong was just getting itself back to rights after three and a half years of Japanese occupation. Three days later, two adventurous fliers would found Cathay Pacific Airways. A few weeks after that, on Oct. 16, Eric Halpern would publish the first issue of the FAR EASTERN ECONOMIC REVIEW.

In Morrison's photographs, the Central District of 60 years ago appears to present-day eyes curiously depopulated, almost a ghost town, despite the fact that the pictures appear to have been taken in mid-morning or afternoon. An influx of refugees from China's civil war was at an

early stage—the population had more than doubled in the previous year to about 1.6 million, but that only brought it back to its prewar level.

It would go on doubling. And many of the new arrivals, fleeing the specter of communism, would bring capital and business know-how from Shanghai and other commercial centers. Soon economic growth would pick up speed, irrevocably changing the colony from a sleepy backwater to the fast-paced trading and manufacturing hub taken for granted today.

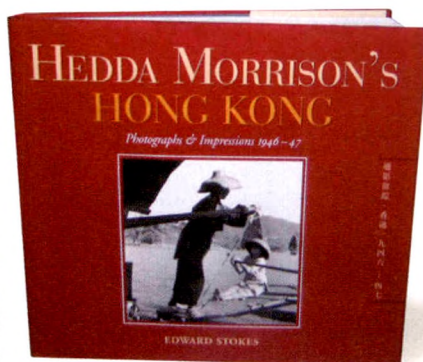
So for anyone familiar with the city, the past in these photographs is truly a foreign country—a place of lightly trafficked streets, fisherfolk and farmers following the natural rhythms of the seasons, and a pristine natural environment. Parts of the harbor waterfront east of Central were just tidal flats where fishing sam-

pans dried their nets; today they are among the densest concrete jungles on the planet. And of course the air was gloriously clean then, affording views of mountains which will probably not be seen again for another 60 years.

Ms. Morrison, who died in 1991, was ideally placed to

capture a unique moment before it blinked unnoticed into history. Mr. Stokes, a local photographer himself, notes:

Hedda Morrison's Hong Kong photographs have historic significance for three reasons beyond their content, range and quality. First, she formed original impressions, with no imposed agenda from any



∞ Mr. Restall is the editor of the REVIEW.

journal, employer or any particular, personal socio-political views—thus adding to the objective evidence that her images provide. Second, despite the troubles that Hong Kong saw from the 1930s to the early 1950s, it was not photographed in detail during that period; neither does one find the concerted work of a single photographer of Hedda's stature. Third, within barely a decade transformations would sweep away much of the traditional Hong Kong life that Morrison's ethnographically-inclined photographs depict so well.

It is fortunate indeed that Morrison, a photographer of some genius, sojourned here between her two periods of concentrated work—in China from 1933-46 and Sarawak from 1947-67. But overshadowed by those collections, her Hong Kong photographs might have been forgotten for much longer save for a couple of coincidences.

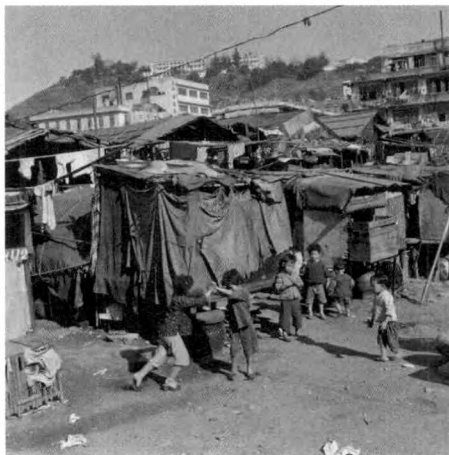
First, Ronald Holmes, the government official who was putting together the colony's annual report for 1946 knew Alastair Morrison's brother and so had heard of Hedda's photography. He ended up using 27 plates in the slim volume. Then in 1995, Mr. Stokes happened across the book, recognized her name and realized the possibility that more such rare views of the period might exist.

After much digging in the Harvard University archives, where Morrison's China archive is stored, 1,000 medium-format negatives came to light, along with a diary. Incredibly, they were still in excellent condition, despite having been stored in Borneo for 20 years. Morrison kept them in rubber-sealed trunks, and maintained a weekly ritual of taking out the silica gel dessiccant to bake it dry in the sun.

Training at the State Institute for Photography in Munich meant she was master of the technical and compositional aspects of her craft. But in all her work one thing stands out: a facility for documenting the local way of life. She was evidently able to win the trust of her subjects, and it may be that her short stature and a limp from a childhood bout of polio made this easier. As her husband put it:



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Hedda would just roam—and if she saw someone she wanted to photograph, she generally did. She never particularly asked permission. She would just go up and (indicate) “Do you mind?”—and they never did. It was partly her manner and

partly, I think, the fact that she was a rare bird... Hedda was quite a small person, but I think it was more a matter of her being a woman.

Also a tremendous amount of prepara-

Morrison was a free spirit, having left her native Stuttgart in 1933 to manage Hartung's Photo Shop in Peking.

tion and shoe leather underpinned her art. Morrison was an intrepid traveler, venturing solo around the Chinese countryside. On one excursion to the Shandong coast, she traveled on board the fishing junks, sleeping on deck. During the war, photo supplies were scarce and living conditions harsh, but as a German citizen she was able to keep working. Her photos of Nanking in 1944 are particularly notable, since they are one of the few wartime records of the city.

As should be clear by now, Morrison was a free spirit, having left her native Stuttgart in 1933 not knowing anyone outside of Germany, to take up a job as manager of Hartung's Photo Shop in Peking. Her rather parochial parents gave her an umbrella and a pistol for his journeys; she dropped both over the steamer's side as soon as she set sail.

After the war, she married Alastair Morrison, who incidentally is the son of G.E. Morrison, the famous Times of London correspondent who lived in Peking from 1897-1920. The two shared a love of travel and local cultures. And for the first time financial security allowed Hedda to devote herself to the pure practice of her art, rather than having to pursue commercial assignments.

The Hong Kong photographs are an excellent introduction to the different cultural groups of the territory that have now largely melded together: the *punti*, or native Cantonese; *hakka*, or guest people, originally from Shanxi and Henan; *tan-*

ka, fishermen from Guangdong; and *hoklo*, fishermen from northern Guangdong and Fujian. Each had their distinct customs and economic niches, with the latter two spending almost their entire lives on the water. Fishing and farming dominated most people's lives—outside of the compact urban center the land quickly reverted to agriculture, with fields and market gardens filling much of Happy Valley and Pokfulam.



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Mr. Stokes, whose father was one of the first British officers to arrive in Hong Kong after the Japanese surrender, provides extensively researched background material on the photographs, including the different ethnic groups. Interspersed are short remembrances from Alastair Morrison.

The damage from the war is clearly visible, for instance in the burned out main building of Hong Kong University and sunken boats in the harbor. Most trees had been cut down for firewood, leaving the hillsides bare and eroding. Most of the cars were taken to Japan, and the infrastructure was in a parlous state.

Rice was not only rationed, but the daily allowance had to be cut because of shortages. The poverty is evident from the hawkers along the streets and the beginnings of shanty towns which would persist for more than a generation. Streetsleepers paid rent to shopowners for a nail on the outside wall on which to hang their few belongings. Children are not shown play-

ing or studying, but rather working or taking care of their younger siblings.

Conspicuously missing are any British faces. This is not surprising given Morrison's interests—in China, Mr. Stokes says, the Swedish explorer Sven Hedin was one of the few Europeans she photographed.

In Hong Kong the British numbered just a few thousand, yet had no trouble regaining control over the millions of Chinese residents.

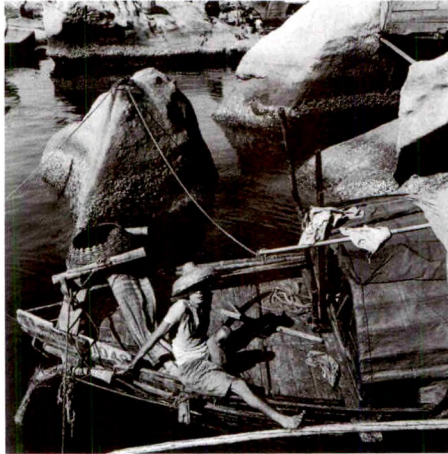
There was little interest in politics on either side. Before the war, Governor Marc Young had proposed political reforms aimed at expanding participation in government, but these plans were shelved. Weary of conflict, we are told in many history books, almost everyone just wanted to get on with rebuilding their lives. Today this indifference seems like a lost opportunity, since we know what fateful consequences it would have once the territory was rich and Britain's 99-year lease on the New Territories was running out.

These photographs help one to under-

stand and accept the intensity of this concentration on economic reconstruction. Not only is there no sign of political activity, there isn't even anything that we might term civil society. Time spent away from work was a luxury that few could afford.

For a sample of the material in the book,

pay a visit to www.heddammorrison.com, where Mr. Stokes and his Hongkong Conservation Photography Association have created a user-friendly introduction to the project. One mind-boggling feature is the juxtaposition of the 1946 images with views of the same spots today. But the Web site is no



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substitute for the book itself, because of the superb quality of the printing. It feels like every grain of the negative has found its way onto the page.

Mr. Stokes says that this book is only the beginning, and he is eager to revive more of Hedda Morrison's forgotten images from China, Hong Kong and Sarawak. There is little doubt that the archives will yield many more negatives that will illuminate foreign lands of the past. ■

THE REBIRTH OF AFGHAN CUISINE

by Jiffer Bourguignon

STANDING BENEATH THE soft industrial glow of the neon kitchen lights, Tamim Samee introduces his chef, Wahid Saberi, to fragrant green basil leaves and the effect of combining them with rich, buttery pine nuts, cloves of pungent raw garlic and sweet fruity olive oil. Though it is not what one might expect to find in an Afghan kitchen, the pesto is surprisingly delicious. "It's the basil fresh from my garden," says Mr. Samee.

This recipe, more Mediterranean than Hindu Kush, is one of a few twists that Mr. Samee, who recently returned to his country of birth after decades abroad, throws in while overseeing his Afghan chef's training. The local cuisine, battered and bruised by the recent decades of conflict, is re-emerging largely intact, albeit with some slight variations, as members of the Afghan diaspora return to the country after the fall of the Taliban in 2001.

Bordering Iran to the west, Uzbekistan and Tajikistan to the north, China to the northeast, and Pakistan to the east and south, Afghanistan lies at the cultural crossroads of the Middle East, Central Asia, the Far East and the Indian subcontinent. Foreign occupation has left an enduring mark on Afghanistan's culture and cuisine. Chinese tea, Indian spices and Persian vegetables were introduced through conquest and trade.

More recently, decades of conflict have also left their mark on the cuisine. Limited resources during the fighting meant that

people were eating to live, not living to eat. Bombing and mines decimated the fields; meat became scarce as refugees were forced to leave animals and land behind. Those who fled the country took much of the country's institutional knowledge with them.

Traditional dishes include *aushak*, handmade dumplings filled with diced spring onions, rolled into a half moon, covered with ground beef, and topped with tangy yogurt and a sprinkling of mint. *Mantu* is a variation of these robust ravioli stuffed with ground beef or lamb. *Boulanie* is a larger but thinner version of a *samosa*—spring onions or potatoes are wrapped in dough which is folded like a napkin. It is then deep fried and served with a spicy coriander salsa or chutney.

The traditional *kebab* is still lunch, dinner or snack of choice—especially for those on the road. Like the drive-up window at McDonald's, buses loaded with travelers pull up to these roadside stands and order a few sticks of the meat wrapped in fresh *naan* and sprinkled with red chili powder and salt. Pieces of meat are alternated with chunks of fat shaven from the *doomba*, the backsides of Afghan sheep, which adds flavor to the somewhat tough morsels.

Dompokt, which literally translates as "baked rice," is a dish reserved not for guests but for those recovering from illness. Seasoned white rice hides chunks of sweet soft carrots and pulled pieces of chicken breast. It is the equivalent of chicken soup for those with memories of the aches and pains of the chilly winter flu season.

Mr. Samee has his own memories of comfort food. "My maternal grandmoth-

~ Ms. Bourguignon is a Kabul-based writer.

er was an excellent cook," he says. "Once a year she would invite me over for a special meal. She would make a dish called *shola*—rice made with fresh herbs, dill, chickpeas, mung beans and broth, like a risotto—it was kind of runny, but sumptuous and juicy. That dish, to me, is family."

Mr. Samee was born in the central neighborhood of Shar-e-Naw in Kabul in 1963. In 1978, following the assassination of King Daoud Khan, a Moscow-backed coup ushered the Soviet-sponsored communist party into power. Successive coups, party rivalries and the increasing popular jihadist resistance culminated in the Soviet invasion of Afghanistan in late December 1979.

The new Soviet authority perceived Mr. Samee's father Basir Samee, the former mayor of Kabul city, as a threat, like all those who had been a part of the previous regime. When at 16 Mr. Samee reached the age of conscription, his father was concerned that he would be drafted to fight in the ongoing struggles between the Soviet occupier and the mujahideen. So his father disguised him as a young porter, dressing him in the traditional *salwar kameez* and *pattu*, a long tunic and loose-fitting pants covered by a wool shawl, and had him smuggled across the border into Peshawar, Pakistan. The young boy soon met his mother and sister in Islamabad and the three gained political asylum in the U.S. There Mr. Samee got a job washing dishes at a neighborhood restaurant and struggled to learn English in a marginalized ESL class with other refugees—Afghans, Iranians, Vietnamese and Koreans.

"Food has a strong association with cul-

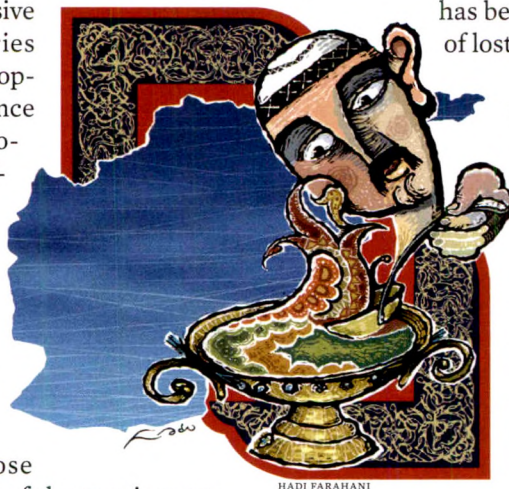
ture for anyone who is or has been part of a society that has been displaced or forgotten by conflict or forced migration," Mr. Samee says. "Different dishes transport you home." Clinging to old family recipes may be due to more than a sudden craving. Food, and the knowledge necessary to prepare it, is a survival mechanism. It is a means of self-preservation that many refugee communities unwittingly embrace as a means of preserving their culture and identity. For this reason, the Afghan diaspora has become a treasure trove of lost culinary gems.

Take the popular television program *Aush Pazi*, or "Cooking Show," which airs four times a week on Afghanistan's young and edgy Tolo network. Although there is no ratings system in place, the show's producer, Nemat Haidary says that evidence of the show's popularity is

in the inbox. "We know because we receive so much fan mail—by email and the post."

But the show's fan base is not limited to Afghanistan: Accolades come from fans in Dubai, Saudi Arabia, Pakistan and Iran. Mr. Haidary says that an interesting trend has emerged from these missives. "The viewers from outside of Afghanistan are always asking for more Afghan recipes," Mr. Haidary says. These recipes are snapshots of home, pieces of memories. The renaissance of Afghan cuisine is a reuniting of the Afghan population—those who fled and those who remained.

Traditional Afghan cuisine has many complex and complementary flavors, textures, and colors, and the detail of these characteristics should not be overlooked, Mr. Samee says—even down to a single



Afghan cuisine, though battered and bruised by the recent decades of conflict, is re-emerging largely intact.

grain of rice. "There are various methods of cooking rice—something that appears so simple—that Afghans are extremely proud of," he boasts. "Every family has a different secret mixture of spices for their *palau* [rice]—it's passed down like a family heirloom." Those receiving these heirlooms are extremely careful with them, especially Afghans who have been forced abroad. These secret mixtures represent a vital link to their culture and family history.

Mr. Samee is now passing his culinary trade secrets on to Mr. Saberi. "Now that some of us who have left are returning, those of us who have continued to cook and entertain in the same way are 'capsuling' these traditions back in," he says. He shuns fast food and focuses instead on revitalizing lost recipes or introducing new ones.

But while Mr. Samee cooks for just a few friends at home, Hashmat Hayat has invited all of Kabul into his grandmother's former dining room for his traditional Afghan cooking. "A renaissance is happening in Afghan cuisine due to the number of Afghans who have returned," says Mr. Hayat, the proprietor of Rumi Restaurant, named for

the great Afghan poet. "I taught our cook [traditional recipes] and he makes them at home now. People love these dishes and are beginning to pass them on. They are trickling down to the mainstream."

Mr. Hayat admits however, that his clientele is primarily expatriates and the Afghan diaspora—his prices are not within the range of an ordinary Afghan. With this in mind, Mr. Hayat deviates from *palau* and *aush*, a tangy yogurt-based soup with noodles and flavored with dill, to include a few different kinds of pizzas. The smell of lamb *kebab* roasting over coals outside mixes with the unmistakable aroma of cheese pizza.

While this might seem like a contradiction, Mr. Samee and Mr. Hayat believe that this renaissance has room for innovation. Combining two worlds, the way he has done in his own life, Mr. Samee prepares to serve dates to break fast at the end of another long day of the holy month of Ramadan. He has removed the pits, stuffed them with blue cheese and drizzled them with local honey. Another variation on a traditional theme, and his guests love it. ■

Ink and Champagne Still Flow

CELEBRATING ITS 60TH birthday, the REVIEW hosted cocktails at Hong Kong's China Club this past month. Pictured below, member of the Dow Jones board David Li, REVIEW Editor Hugo Restall and The Wall Street Journal Editorial Page Editor Paul Gigot toast the magazine's past accomplishments and future ambitions.



Yahoo's Shame

AFTER GETTING JOURNALIST Shi Tao thrown in jail for 10 years by voluntarily turning over his emails to the Chinese government, Yahoo! is evidently starting to feel a little shame. The company has sponsored an international fellowship for journalists at Stanford. Yahoo! co-founder Jerry Yang gave this gag-inducing homily: "While citizens around the world are benefiting greatly from increased access to information, particularly through vehicles such as the Internet, the journalists who distill that information are still under pressure in many nations. We hope that fellows visiting from press-restrictive nations will have the opportunity to bring change and enlightenment to their home countries." How about some change and enlightenment in your own home, Jerry, starting with an apology to Shi Tao?

Brothers in B.S.

NORTH KOREA'S NUCLEAR test dismayed most people in the region—but not all. The Kim family style of florid and fiery rhetoric has a fan in Communist Party of the Philippines' spokesman Gregorio "Ka Roger" Rosal: "The development of nuclear capability in the hands of independent countries that persist in the fight against U.S. hegemonism and aggression realistically deters the U.S. from using its nuclear weapons and military might to attack these countries, and is thus a positive factor in our common striving for genuine peace in the world."

Bloody Tourists!

USUALLY THE LOCALS are the ones complaining about swarms of tourists creating problems in their home towns. But in Bangkok it's the other way round—travelers at the new Suvarnabhumi Airport are being inconvenienced by thousands of Thais flocking in to gawk at the new building. Not to mention using the already hopelessly inadequate toilet facilities.

Baptism by Water

IT HAPPENS TO the best of them—sinkings periodically disrupt the Boat Race, run annually between Oxford and Cambridge. So Peking University and its Olympic hopeful rowers shouldn't feel too bad that they went down to defeat, quite literally, in Boston's Head of the Charles race. And they can blame it on the U.S. government—their coxswain had trouble getting a visa and so a replacement was drafted from MIT.

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FAR EASTERN ECONOMIC REVIEW

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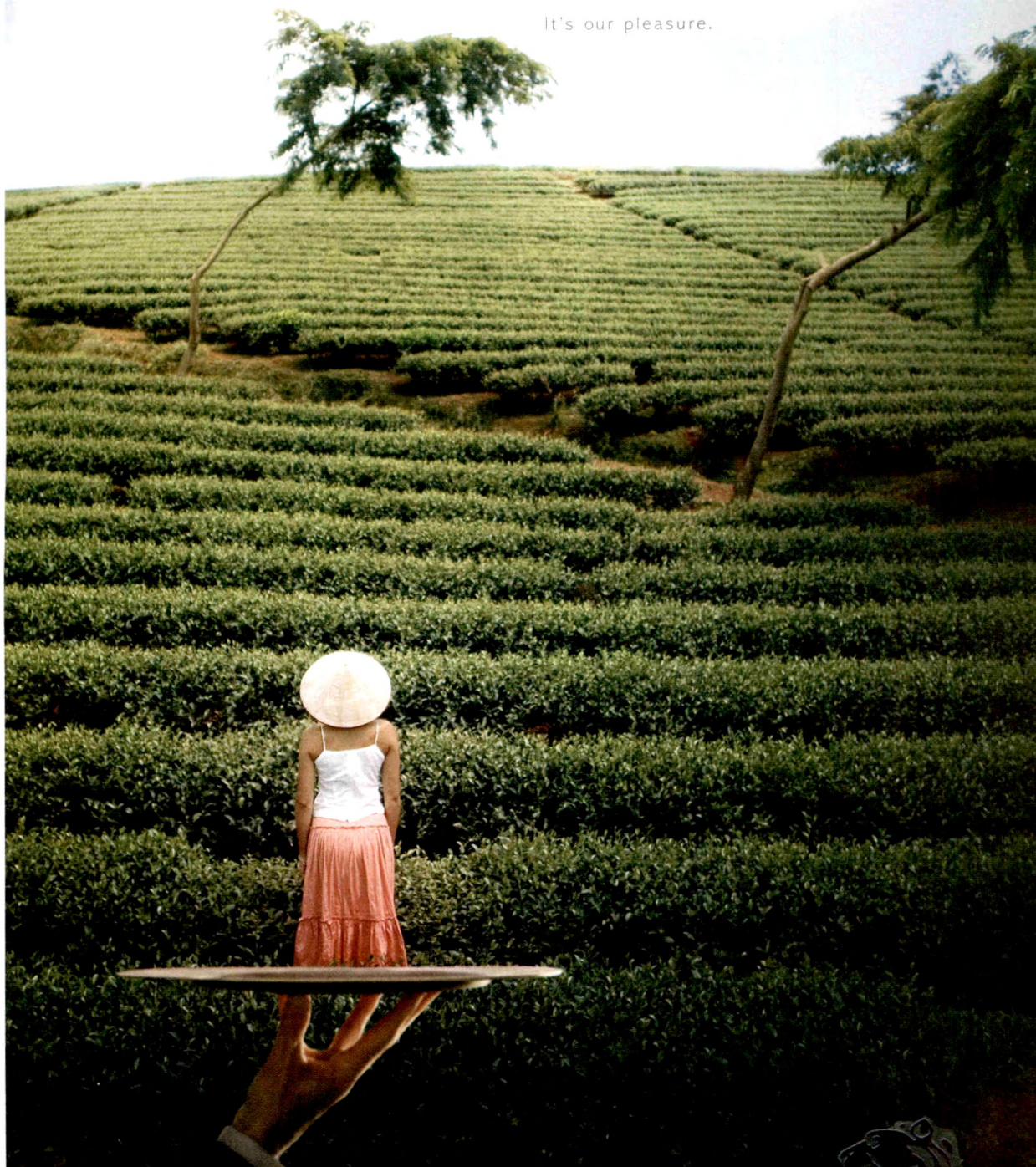
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VACLAV HAVEL, PLAYWRIGHT and dissident in communist Czechoslovakia, once wrote about the concept of “anti-political politics,” or politics “from below.” Those who seem most powerless actually can have the greatest power, because their willingness to lay everything on the line for their beliefs permeates the collective subconscious of society.

From our vantage point today, when freedom has triumphed over totalitarian regimes almost everywhere, it is hard to imagine how strong Mr. Havel’s optimism about the resilience of the human spirit must have been to sustain his beliefs during many bleak years in prison. His writings also bring to mind the Christian teaching that the last shall be first, and the meek shall inherit the earth. Which is hardly surprising, given that the early church was shaped by a similar kind of persecution at the hands of the Romans.

This past month I had the opportunity to meet and interview Shih Ming-teh, a true Taiwanese hero who has been compared to Mr. Havel and South Africa’s Nelson Mandela. That is not to say that he is without flaws; during his own years in prison he had moments of despair. In 1980, after already having served 15 years for opposing the Kuomintang regime, he begged to be sentenced to death rather than sent back to jail. But then when the KMT regime was faltering, he found new reserves of strength and went on hunger strike for several years, undergoing force-feeding thousands of times, until his demands were met.

Today, both in Taiwan and mainland China, there is no longer a totalitarian regime to struggle against, although varying degrees of injustice remain. This poses a different challenge to “live in truth,” as Mr. Havel put it, that is more within the reach of us ordinary mortals. Mr. Shih is meeting that challenge by harnessing the anger of Taiwanese citizens at their president’s corruption to build a bottom-up movement that will hopefully help the island’s young democracy mature.

Meanwhile, in mainland China, young, well-educated Chinese are increasingly turning to Christianity as a way to create a new framework within which they can lead ethical and meaningful lives. As Leslie Hook writes, to the extent that it is political, conversion is a private expression of intellectual independence and commitment to humanist values in a society that is morally adrift. Repulsed by the corruption and cruelty fostered by the Communist Party, many Chinese see faith as a way for them to live in truth while still rendering unto Caesar. That may help China to forge the “harmonious society” the Party claims to want.

H.R.



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LETTERS

Mr. Ma Clears Up Doubts

I WOULD LIKE to congratulate the REVIEW on its decision to invite Mr. Ma Ying-jeou to say what he earnestly thinks about Taiwan and its cross-Straits relations with China. Unfortunately there has been a lot of confusion surrounding Mr. Ma and his thought in this regard since he assumed chairmanship of the Kuomintang.

Because apparently he is talking in the capacity of the KMT's chairman instead of Taipei City's mayor, I have to point out, as a citizen of Taipei and a Taiwanese national, a few stark facts contradictory to what Mr. Ma says here. Mr. Ma is a well-known supporter of the "ultimate goal of unification with China." His constituency supports him for this reason. Therefore to trade away Taiwan's sovereignty and independence for China's withdrawal of 800 missiles, according to Mr. Ma's "five dos," merely serves the goal of unification.

Mr. Ma also puts a lot of emphasis on Taiwan's national defense in terms of his "two feet" policy. But it is precisely Mr. Ma and his KMT who have not only backpedaled but also crippled and hamstrung Taiwan's efforts to beef up its defense force. The pan-blue alliance led by the KMT in the parliament has blocked military purchases for the past six years. Even if these bills can be passed by Mr. Ma today, our boys in the military will still have to wait till 2016 for new weapons to defend their country

THE FAR EASTERN ECONOMIC REVIEW welcomes letters to the editor sent via fax to (852) 2503-1530, by email to letters@feer.com or by post to GPO Box 160, Hong Kong. Submissions must include the author's full name, address and daytime contact numbers. The REVIEW reserves the right to edit letters for length and clarity.

and family. Comparing Mr. Ma's remarks in the REVIEW to his deeds in Taipei betrays his real intentions and clears away so much misunderstanding.

Samuel Wu
Taipei, Taiwan

Oh Puh-leeze

DATUK ANWAR IBRAHIM'S November essay "Radical Islam in Southeast Asia" is full of the usual apologia for Islamic misbehavior that we have come to expect from a plethora of Muslim intellectuals, whether Arab or Asian. As usual, Mr. Anwar repeats the canard that the Palestine problem is due to Israeli and American intransigence alone.

Thus, if only the Jews would just let the Palestinians alone, former Prime Minister Mahathir Mohamad of Malaysia would stop being an anti-Semite and Iranian President Mahmoud Ahmadinejad would undergo a radical transformation in which he could contemplate a Jewish state on the planet. Oh please. The source for Islamic bigotry and lack of tolerance is to be found within Islam and not in some "neo-Orientalist" writings by Clifford Geertz or Bernard Lewis.

Peter Cohen
Honolulu

Lost in Translation

IN HER REVIEW of the novel *The Banquet Bug*, Leslie Hook mentions that some of character's English names seem less than plausible, thereby compromising the book's authenticity. Quite the contrary—I have lived in Shanghai on and off for 10 years and names like Steel and Ocean would not even make me blink. Some of the real-

life characters that have entered my orbit have included Satan, Devil, Chanel, Prada and Pepsi. In fact, some are so amusing I now regret not keeping a notebook on the subject. In my view, Ms. Yan has captured one of the quirkiest fads in contemporary Chinese society with perfection.

Some young people also change these names frequently, leading to introductions such as "You remember Gucci, formally known as Rocket." China today is a bizarre place, you have to come live it to truly understand how impossible it is to comprehend.

Susan Zhou
Shanghai

Singapore Days

I READ WITH great interest the material posted on your Web site about the defamation lawsuits against you, and the articles on Singapore's education system and Mr. Chee. Speaking as a Singaporean, I am heartened that unlike others you have not capitulated and have instead decided to soldier on. I wish you all the best, and will as a small token of my good wishes take up a subscription with your journal.

Dawn Tan
Singapore

ON THE ONE hand, I am not convinced that press censorship is bad for Singapore. On the other hand, being a graduate student, I would like to see more open discussion between scholars in Singapore. I feel that a true intellect-oriented society is one that allows Platonic style discussions. An incorrect viewpoint should be corrected via dialogue, not via lawsuits. To instill fear among intellects to discuss freely is counter to Singapore's dream of "intellect progress." However, we can only move from the present widespread "free discussion censorship" to "more freedom in public discussions" slowly. I do not feel we have an

intellectual foundation for this.

I would like to give the present prime minister of my country more time to open the floodgates of intellectual freedom. At the same time, I fear that the government might shut these gates further as opposed to performing any form of calculated decision on how much intellectual freedom we deserve. I fear they may decide to become too conservative when making such decisions, which might hinder us from achieving as much as we are able to achieve. As such, I am content that the REVIEW is making a stand in the present lawsuit by Singapore. I think this is necessary in order to keep issues and policies related to "intellectual freedom" in Singapore in check.

Sunil Sandhu
Palo Alto, California

WITH REFERENCE TO the ban on the REVIEW by the Singaporean government, there is no question that the interview with Chee Soon Juan is defamatory. By the same line of reasoning perhaps the various staff of the REVIEW should all be classified as probable murderers because there has never been a proper audit of the cupboards in their respective properties.

It is very disappointing that the REVIEW and a few journalists repeatedly choose to highlight unsubstantiated points made by Mr. Chee, whose popularity is questionable even among Singaporeans supporting the political alternative. It is a disturbing matter that the REVIEW, while professing to support a fully free democracy in Singapore, does not give sufficient coverage to opposition politicians like Chiam See Tong or Low Thia Khiang, who represent the real political alternative. Instead much attention is focused on fringe viewpoints.

Research on the subject of lawsuits in Singapore shows that Mr. Chiam brought three members of the ruling party to court for libel. All three apologized and paid damages. The omission to mention this



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event naturally does not make any claim of balanced reporting a credible one.

Perhaps the most sobering thought is this: It might be the view of the REVIEW that most Singaporeans sympathize with them on this issue. For Chiam See Tong and Low Thia Khiang they would and did before on the issue of political fairness with a street protest, but not for Chee Soon Juan. Get the hint yet?

Patrick Lim
New York

READING THE OCTOBER editor's letter about the defamation lawsuit brought against the magazine, I strongly support your cause. By refusing to succumb under intense pressure from Lee Kuan Yew, you have achieved a huge success for the people of Singapore. Thank you for exposing such deeds which indeed shame Singapore despite our supposedly "squeaky-clean" image.

It is now high time that the world recognizes what lies beneath the surface, a turmoil of unrest that is carefully suppressed by this oppressive regime. Thank you for providing an alternative perspective to a nation which has been drowning in nauseating praise. I wish you all the best and support you for the upcoming lawsuit.

Ng Yiqin
Singapore

On the Merits

I READ MICHAEL BARR'S October essay "The Charade of Meritocracy" with an absolutely open mind and was sadly disappointed by its empty conclusions. I found no evidence in the article of racial discrimination whatsoever.

He paraded a long list of statistics which basically shows how well the Chinese have been doing in Singapore compared to the other races, and he concludes that this proves that discrimination exists in Sin-

gapore. This is simply a gross misinterpretation of the evidence! All that this shows is that the Chinese are doing better than the other races in Singapore. I am glad that Mr. Barr is not a policeman, otherwise he would just conclude that anyone standing next to a dead body must be a murderer.

Dr. Jen Shek Wei
Singapore

BY CHANCE I saw the REVIEW's October 2006 issue in the Flushing Library today. I was very amused that two Australian political scientists are sniping at "freedom" in Singapore. Australia is the most white racist country, next to South Africa under Botha. It can "lecture" Singapore?

As a young man 30 years ago I was influenced by your magazine's pseudo-intellectual hubris in Southeast Asia. I wonder whether the REVIEW has any more relevance. All the wealthy Asian countries did not follow the Western democratic models. Derek Davies and Ho Kwon Ping have long gone. When the REVIEW disappears from Asia, the white, democratic garbage will not be missed. Mr. Lee raised a communist-controlled swamp to First World status!

Victor Ho
Ridgewood, New York

I SUGGEST AN ALTERNATIVE postcolonial reading of Singapore's policy to promote the teaching of Chinese, Tamil and Malay in schools. The promotion of these Asian languages was an attempt by a multiethnic state to prevent erosion of these languages, and the eventual loss of the ability of its citizens to speak their mother tongues. The Singapore project to develop these languages was really intended to ensure that English—the *lingua franca* of business, law and higher education—would not completely erase Mandarin, Tamil and Malay.

Harish Mehta
Toronto



Christianity Comes To China's Cities

by Leslie Hook



WHEN THE COMMUNIST Party came to power in 1949, just under 0.8% of Chinese were baptized Christians. Today, the government officially counts 21 million Catholics and Protestants combined, or 1.6% of the population. But this is a gross underestimate, since the majority of Christians do not attend official churches. An 85-year-old retired pastor in Beijing, who asked that his name not be used, claims that one in 10 Chinese are Christian. The 2003 book *Jesus in Beijing* by David Aikman cites another estimate of around 80 million Catholics and Protestants combined—6% of the population.

Even more significant than the fact that Christianity is spreading, is that it is making major inroads for the first time among the middle classes and intellectuals in towns and cities. "Before the year 2000, most believers were in the countryside," says Beijing writer Yu Jie, who converted in 2003. "After 2000, they started to move into urban centers, cities like Beijing, Shanghai and Guangzhou—it started spreading among central intellectuals."

While most Chinese Christians see their faith as separate from politics, the phenomenon has huge implications for the country's political and social development. Conventional wisdom has it that Christianity fills a vacuum left by the loss of faith in communist ideology. But interpreting this shift as simply one faith replacing another underestimates its importance. Christianity is attracting educated Chinese who don't necessarily want an all-encompassing dogma to rule their lives, but rather a humanistic framework in which they have a large degree of intellectual freedom. Moreover, Christianity is providing an alternate system of societal values to address problems that have emerged since China began its transition to a free-market economy.

Repression Breeds Vitality

THE CHURCH IS growing despite—or perhaps even because of—government at-

Ms. Hook is a recent graduate of Princeton University and a Princeton in Asia fellow at the REVIEW.

tempts to control it over the last several decades. In the early 1950s, Protestant and Catholic leaders were forced to join the Protestant Three-Self Patriotic Movement and the Catholic Patriotic Association respectively—essentially state organs of the Bureau of Religious Affairs that were intended to ensure that Christianity stayed under control. Many were imprisoned because they refused to do so.

The 85-year-old pastor describes how the growth of the church in China, despite government restrictions, mirrors that of the early Christian church persecuted by Roman authorities. But the futility of that response is now evident. “Right now the response [of the Bureau of Religious Affairs] is *mei banfa*—they have no idea what to do,” he says. Although the government at first tried to constrict churches through arrests and harassment, he says that they have realized that approach only backfires. “If they arrested the head of one house church, the congregation would just split up, and might break into five, six, or even 10 new house churches.”

Over the last century Christianity remained most popular in the countryside, where Western missionaries had attracted poorer, less-educated converts. The elderly pastor describes how during the decades before 1949, people who were educated and well-off had no interest in Christianity. “The educated basically rejected these foreign things.”

What has changed today? Surprisingly, many urban Christians say the religion is a force contributing to China’s development intellectually, economically and socially. In other words, although the faith of most is personal and not political, there is a strong belief that faith and progress are linked. Christianity, they believe, can help China to become great, to modernize, to develop further.

“Faith and politics are definitely connected,” says one well-known dissident,

who asks not to be identified as he has been forbidden to talk to journalists. As we stroll around the lakes by the west gate of Peking University, he muses, “What would China be like if its leaders were Christian? If even 50% of its cops were Christian? You can’t even imagine... It would change so many things.”

Even those who reject a direct connection between Christianity and politics talk about the potential benefits of Christianity for a democracy. “I think that democracy and Christianity have some things to say to each other. But you can’t use one to get to the other,” says Mr. Yu, the writer and intellectual. He feels that people are mistaken to view democracy and Christianity as a united front of thought, but that faith could be beneficial to society. “A democratic society naturally has many problems,” he says. “But if more people were Christian then it would be good for society. People would love each other more.... A society without religion cannot be a good democracy.”

A recent trend of Chinese Christian lawyers who feel called by their faith to take on pro bono human-rights cases also demonstrates this. When Mr. Yu met with President George W. Bush in May, the two people accompanying him were Chinese Christian lawyers, Wang Yi and Li Baiguang—and both of them, like Mr. Yu, had converted during the last couple of years. Mr. Yu explains that this area of work is one of the unique aspects of the church he attends, Fangcheng, or the Ark Church, in Beijing. “Our church wants social equality,” he begins, describing some of their social service programs. “And we happen to have a lot of lawyers, so they can provide free services to people who have suffered harm, whether or not they are Christian.”

Recently the connection between Christianity and capitalism has also become a hot topic of discussion. One of the

most high-profile believers in an explicit link is Zhao Xiao, a young economist who is currently a post-doctoral economics student at Peking University. Early this year, he published an 11-page essay in the Chinese edition of Esquire magazine entitled "God Is My CEO."

Mr. Zhao began by talking about the central role of the Christian faith in the U.S., and then laid out what he sees as some of the pros and cons of a market economy: "A market economy has the great benefit of teaching people not to be lazy. However, a market economy cannot teach people not to lie, or not to harm others. This is where the danger in a market economy lies."

Quoting Max Weber's *The Protestant Ethic and the Spirit of Capitalism*, he outlined how the presence of the church in a market economy can help people to trust each other, and give them a basis for mutual respect. Another benefit of the church in a market economy is that it can "guide the way that wealth is used, and alleviate the tensions between the rich and the poor" by encouraging tithing and charity work. Finally he profiled several successful Christian businessmen, including Richard Chang, CEO of Taiwan's Semiconductor Manufacturing International Corporation, Shi Dakun, president of Motorola China, and Chan Kei Thong, founder and CEO of Leadership Development International.

Multiple Avenues to Faith

SINCE CHINA BEGAN to open up in the 1980s the number of intellectuals who travel abroad for part of their education has steadily increased. As these

students try to come to terms with their foreign surroundings, many of them get invited to attend church, where they find friendly faces and discover a sense of community. "Right now a lot of the Chinese abroad, especially in North America, are Christian," says Mr. Yu. "These people who convert abroad have been coming back in the last few years." Not only do these overseas Christians have an impact when they return to China, they also work to convert their families and friends while still abroad, or do evangelical work on the side when they come back to China for business trips.

China's internal migration also contributes to the spread of Christianity. Factory workers who leave their homes in the countryside to find work in the city sometimes find God along the way. Cities like Wenzhou, a famous manufacturing capital in Zhejiang province with a large and active Christian population, spread the gospel as they spread their trade. Christian factory owners often give their workers Sundays and church holidays off, a practice that contrasts with the 24/7 operations of many competitors.

People who move out of relatively Christian areas bring their Bibles with them wherever they go. One Christian woman from Wenzhou describes how she and her husband had helped the small church in Jishou, in western Hunan Province, that they joined when they moved four years ago to open a shop selling sweat-ers. "There aren't very many Christians in Jishou," she says disappointedly, explaining that a



The connection between Christianity and capitalism has become a hot topic of discussion.

lot of the members of the church were from out of town. "Our church is short of pastors and teachers, so everyone takes turns helping out. My husband even preaches sometimes." In the past few years they and other immigrants have been instrumental in helping the church find a permanent room to rent—not just someone's home—and grow into a congregation of around 100 people.

China's different generations each experience Christianity in their own way. People in their 20s associate religious exploration with the freedom that comes from entering college. "In high school you study all day, but in college you have more freedom, you meet more people, and you become familiar with more aspects of society," says a 21-year-old medical student at Peking University Health Science Center, who asked that her name not be used. For her, college social life brought her to church. "You meet so many people in college," she explains, and "many people first come to church with friends when they are freshmen." For others, it is the intellectual life at college that draws them to explore religion. "For the first time in my life, I had time to read," a free-lance journalist recalls of his conversion to Christianity that began while he was a student at Beijing Communications University.

One Tsinghua University graduate explains that for him Christianity is an expression of intellectual freedom. Students

who master the education system and succeed in attending university have had to jump through ideological hoops their

whole lives in order to succeed, he continues. Even joining the Communist Party is one more step on this conventional path, however little one agrees with their ideas. So when the opportunity arises, choosing to become a Christian can signal something of a private rebellion.

Many college students and recent graduates, regardless of their religious beliefs, identify openness to-

wards religious experimentation as a characteristic of their generation. "It's easier for my generation to accept new faith, because our world is always changing so much, especially compared to our parent's generation," said Raymond, who struck up a conversation as he was browsing through the religion section in a bookstore near Tsinghua. Though currently agnostic, he is planning to pursue a master's degree in Buddhist studies, and plans to choose a religion for himself after his studies. "Everyone needs a faith," he says. The medical student at Peking University agrees: "Society has developed so fast—we're just used to adapting."

But Christian students at universities also face some unique challenges. Bible studies and worship groups are restricted on many campuses, and Christian students often keep their faith to themselves for fear of recrimination if they were found



HARRY HARRISON

out. "If the teachers knew that I was a Christian, that would be bad," says the medical student at Peking University. When asked to elaborate, she looks embarrassed and reveals that she has recently joined the Communist Party, which forbids its members from believing in any religious doctrine.

Her Communist Party membership, she explains, is just a step on the path to having the life that God intended for her. "I have to live in China, and I want to achieve a good position in life, so it's best to be a Party member." She refers to *The Purpose-Driven Life* by Rick Warren, a book popular in the United States, and explains how being a Party member will enable her to use her medical studies for the purpose God intended. "The purpose that God has chosen for me is to alleviate the suffering of others and to heal them, so becoming a party member is a step on this path."

Meeting Christians who are also party members is not uncommon, and many in Beijing bring up disillusionment with communism to explain the trend of Christian conversion among China's intellectuals. The 85-year-old pastor in Beijing says that doubts about communism started when people began to be able to go abroad. "The most typical example is Yuan Zhiming," he says. "[He and others like him] researched communism till they were blue in the face. He got his doctorate in Marx-Engels thought, and then he was a university professor teaching Marx-Engels thought. But when they got to the U.S. they saw that it wasn't like that. They looked for the truth and discovered, *aiya*, we've been cheated. Pursuing a faith would be beneficial." Mr. Yuan became a Christian after being exiled to the U.S. for his role in the Tiananmen demonstrations, and has made several famous documentary films, including *River Elegy*, and *The Cross*, which looks at China's underground churches.

Others bring up disillusionment with the democracy movement to explain how they've come to their faith. Mr. Yu says the recent trend of intellectuals converting stems from the failures of the Tiananmen democracy movement in 1989. "There was a big group of intellectuals and students who went to the West [after Tiananmen]... But the internal struggles of this movement made a lot of people disappointed and bitter." He explains that a weakened faith in democracy led some former activists who were abroad to search for something else, and some intellectuals still in China had followed suit. "They started to think that they needed something more—a religious faith—so many became Christian." He lists off of the leaders of Tiananmen who have since become Christian, including Mr. Yuan. "There are five or six leaders who are now Christian, which is quite a lot considering that's out of a pool of about 30." He continues, "When these guys [who were abroad] became Christian, the young intellectuals who were still in China began to pay attention. At that time a lot of them were feeling quite hopeless."

From Mr. Yu's perspective, Christianity is also attractive to the minority of intellectuals who have not "sold out"—become more conservative and less critical of Chinese government and society in exchange for higher income and more comfortable lives. "Starting in 1990, the government began to change its policies towards intellectuals," he explains. "Professors could have a higher salary, a better position... Only a small minority still persevere and speak the truth, but even if you speak the truth you might be ostracized—like Jiao Guobiao," he says, referring to a professor at Peking University who lost his job after publishing a vitriolic criticism of the Central Propaganda Department, and recently became a Christian as well. "So the small minority that persevered felt very

Some believers identify disillusionment with the democracy movement as a step on their path to faith.

isolated, and they needed something more to turn to.”

This trend of democracy advocates who have converted to Christianity highlights the uncomfortable association between religion and political activism. Uncomfortable because there are deep disagreements within the Christian camp between those who see Christianity as a necessary background for a democratic society in the future, and those who strongly oppose any such association.

In response to a direct question about the political implications of their Christian faith, most people say there aren't any. “Politics is very, very far away from the average Christian,” says the Christian freelance writer. “Rendering unto Caesar what is Caesar's,” he says, quoting Jesus' response when asked whether Christians should obey non-Christian government leaders.

Mr. Yu says the question of how Christianity and democracy are related has been a divisive issue in his church. “For me it's clear. First I am a Christian. Second I am a writer. I am not a politician. It doesn't matter to me whether China becomes a democracy. I'm an intellectual and so I criticize society, but I don't have a hidden agenda.” He mentions one prominent human-rights lawyer—Gao Zhisheng, who became Christian in 2005 and is now under detention—who he felt was using Christianity as a tool to further his democracy agenda. “We found that he wasn't so interested in the church, but rather in using the church as an arena for his own beliefs.”

Rural Emotions

TWO HUNDRED AND seventy kilometers from the birthplace of Mao Zedong, Tan

Chuntao's eyes glisten as she describes the near-death experience that led her to decide to attend seminary for two years. “When they were doing surgery on me on the eighth floor of the hospital, I kept hearing this song inside my head. It's hymn number 250,” and she starts singing. “I had never heard that song before, but I had it running through my head the whole time. So after that I taught the hymn to the congregation.”

With her crisp green Mao jacket, her warm face, straight posture, the fervor in her features, Ms. Tan could be a character in a propaganda film if it weren't for the fact that she were singing a hymn. We are in the sleepy township of Xinqiao, in northern Hunan province, and Ms. Tan is the local party secretary's wife. Around us are gardens with leafy greens and rice paddies lying fallow for the winter. With two paved streets and a two-storey school building, Xinqiaozhen is well-off compared to much of China's countryside. Even more impressive is the village's brand new church, just completed in April with funding from a congregation in the U.S.

Hunan is not particularly known as a hotbed of Christianity—that honor goes to provinces like Henan, Zhejiang, Hubei and Anhui—but Ms. Tan says all the churches in the area are growing. “Christianity has developed very quickly in Xinqiao,” she says, counting four official churches and two house churches in the township, and estimating around 1,000 Christians out of a population of 90,000. Most of the Christians here are women, a trend that holds true across China but particularly in the countryside.

In the nearby town of Zhangjiajie, the gender divide is stark. The town's church—a stately pink-and-cream stone building

built in 1905 by a Finnish missionary—holds around 600 people. But even though the pews are overflowing on Sunday morning, only a handful of men are visible, and the average age of the congregation is pushing 70. This demographic profile is not uncommon in rural areas, where Christianity has thrived since before the Communist Party came to power, but it is in sharp contrast with urban churches where men and women, old and young, seem to be in equal proportion. This demographic divide is one reason for the deep ideological divide between China's rural and urban churches.

Urban believers might cringe or sigh at experiences like those describes by Ms. Tan, which they perceive as overly emotional and pseudo-superstitious. Mr. Yu sums up some of the ideological differences: "Believing in Christ should be balanced between reason and emotion. But in the countryside [faith] leans more towards the emotional side. On Sundays, they might yell loudly, or cry. Sometimes it goes too far.... They think they don't need to go to the hospital to heal themselves—like Falun Gong. That really worries me."

But love it or hate it, urbanites don't deny that Christianity's current boom in the cities is largely due to the religion's strong rural roots. With few exceptions, Christians I met in Beijing had a relative or two in the countryside who converted before they did. One example is the Beijing dissident who recently became a Christian—in fact almost all of his family, who live in the countryside in Henan province, are Christian. He says having Christianity in the countryside is a "good foundation" for Christianity to spread in the cities. Yet he hesitates slightly when asked if his faith is the same as that of his relatives. "There is a big difference in how you worship on Sunday, but not in the basic beliefs."

Nevertheless, the importance of Chris-

tianity in the countryside is impossible to overestimate. A college student in Beijing says that for students, having a grandmother back home who is a Christian and can "talk to them about things like this," makes them much more likely to explore Christianity when they go to college. And the 85-year-old pastor reflects that every single true missionary he knows is from a poor, rural background.

So what does this demographic shift mean for the future of Christianity in China? Many in Beijing were optimistic that the presence of more, better-educated Christians in China would only smooth the way for greater religious freedom in the future. "We are not far from an era of religious freedom in China," says one Christian intellectual as we sit in a pagoda on the campus of Peking University. "Before, the peasants used rough, wild methods [to express their faith]. But now there are more educated Christians, so it will be easier for there to be more freedom."

Although this may be an oversimplification, he is probably not wrong. A few days later and thousands of kilometers away, I end up sharing a sleeper car with three middle-aged cadres from various parts of Hunan. As an icebreaker, they ask rather earnestly what my opinion of Chairman Mao is. Yet when I told them I was working on a story about Christianity they were almost encouraging. "Well, if you're a party member like we are you can't believe in another religion, because communism is your faith," said Mr. Peng, a balding 33-year-old high school principal. "But religion is just fine for non-Party members." In fact a small church had just been built in his town, he said. The three of them took turns explaining to me that religion could actually be a good thing, because it could help build a more "harmonious society"—echoing the catchphrase of President Hu Jintao. ■



Japan's Big Bang: Too Little, Too Late?

by Jean-François Minier

TWENTY YEARS AGO the United Kingdom's financial system underwent an enormous transformation. The "Big Bang" propelled London from what had become a sleepy, domestic financial center to the world's most important financial hub—even ahead of New York. It also spurred job creation and nurtured the rebirth of the British economy, which had lost much of its competitive sparkle in the decades since World War II, and it helped the U.K. better prepare for an ageing society by resuscitating its almost-collapsed pension system.

A decade later, Japan also had its own version of the Big Bang. But unlike the U.K.'s, Japan's did not result in as wide-ranging a reform. Today, much still remains to be done to make Tokyo a global financial center on par with New York or London—and even to ward off the mounting threat to its status as Asia's leading financial center posed by Hong Kong, Shanghai and Singapore.

On Japan's things-to-do list for the financial industry: deregulation of cross-

sector entry; development of genuine rule-based supervision; harmonization of accounting standards to global norms; increasing the reliability of the country's stock exchanges; improving the quality of its start-up markets; and forging stronger links with the financial systems of other Asian economies, especially with China.

Free, Fair and Global

WHEN JAPAN'S THEN prime minister, Ryutaro Hashimoto, launched his Financial Reform Initiative in November 1996, his objective was to produce a set of financial reforms—to be implemented by 2001—that would shake up the Ministry of Finance and the Bank of Japan and allow Tokyo to become a "free, fair and global" financial market. Pension reform, as well as the clean-up of the banking sector's enormous bad loans problem, conveniently were left for subsequent administra-

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tions to tackle. Yet even with this relatively narrow scope, the success of the reform initiative has been patchy, to say the least. As the table nearby shows, of the 11 “must-do” objectives set by the Hashimoto administration, only eight have been completed. More importantly, given the phenomenal growth of global financial markets in recent years, the “must-do” list should probably be twice as long now.

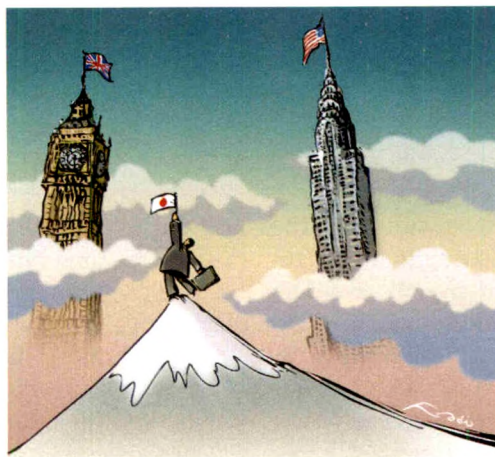
At the September 2006 IMF/World Bank meetings in Singapore, I discussed funding flows and Asian financial centers with a senior executive of the World Bank. We marveled at the recovery of the region over these past 10 years and also agreed on just how important Japanese investors were to ensuring funding needs at reasonable cost to the World Bank. We were also puzzled, however, at why Japan had not managed to keep up with other global financial centers—London and New York in particular—and how it was being challenged by Singapore, Hong Kong and perhaps Shanghai in the future. We wondered if Tokyo markets would see the same fate as the harbors of Yokohama and Kobe, which saw Hong Kong, Singapore and other Asian harbors overtake them in the past 20 years.

Singapore and Hong Kong, through a combination of tax incentives, infrastructure development and integration into the global financial flows passing through China, have managed to flourish in areas such as private banking, asset management and back office outsourcing. This has attracted jobs that were previously per-

formed in other financial centers around the globe and also has created new ones. Shanghai is less advanced and does not represent an immediate threat to Tokyo, but with China now possessing the largest foreign-currency reserves in the world (more than \$1 trillion) and having already become the second-most important economy on the global agenda, it can only be expected that its growth will accelerate over the next few years.

Back in Tokyo later that week at a dinner attended by senior executives of Japanese securities firms, the conversation turned to the state of the country's bond market. We agreed that, despite having the largest Treasury bond market in the world, Japan's bond markets were underdeveloped since all other segments (corporate, municipal, asset-backed and high-yield) were insignificant on an international scale. This in turn has contributed to the slow development of the domestic credit-derivatives market as well. In conclusion, it was agreed that prior to focusing on the Asian bond markets through numerous government-sponsored initiatives, it would be prudent for Japanese financial institutions, supported by the government, to first develop the domestic bond market in a manner that does not rely on banks or the state to distribute credit to corporations and local authorities.

While having benefited from product liberalization embedded in the Big Bang measures (especially securitization), the retail side is still below global norms due primarily to limited financing options



HADI FARAHANI

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Why has Japan missed the opportunity to mold itself into a powerhouse of global finance?

faced by individuals and SMEs. The lack of a strong financing strategy by banks for smaller firms and individuals spurred the development of the less efficient and more expensive consumer-finance industry and even prompted regulators to dole out numerical targets to the megabanks for growing the proportion of their loans to SMEs—not exactly a market solution to financing needs.

The equity markets are not much better off. The infrastructure issues of the various exchanges (system breakdown, reputation issues with newly listed companies, etc.) are well documented. Less well-known is the fact that Tokyo has continued to slip in terms of trade volumes when compared to New York or Europe. Tokyo has also been unable to keep up with London in capturing listings from rapidly-developing economies, such as China and Russia.

And in foreign exchange, Tokyo has continued to lose volume and staff to Singapore and Hong Kong where most of the regional foreign-exchange teams are now located.

Missed Opportunity

AT THEIR INCEPTION, the Big Bang measures were expected to facilitate the shift from indirect financing driven by bank credit toward direct financing driven by securities markets. This would have allowed for more efficient distribution of funds toward well-managed and growth-generating companies, adding up to 0.3 percentage points to long-term potential GDP, according to 1997 estimates by the Ministry of International Trade and Industry (MITI). Given that actual GDP growth during the period 1996 to 2006 was a very modest 1.3% in real terms and 0.2% in nominal terms,

Japan could have done with this much-needed boost to its economic performance. In addition, full implementation of these measures would have supported efficient management of the vast financial assets of the Japanese people, possibly even partially compensating for a pension and welfare system financially strained by a rapidly aging population. Progress has taken place but to a degree much lower than originally expected. As a result, only partial reforms of the pension system have been possible, making future reforms potentially more pressing and more painful.

Another consequence of Tokyo's inability to become a true global financial market is that Japanese companies will find it increasingly difficult to thrive in the international business environment where global consolidation battles have become more common. As seen in the recent takeover battle for Luxembourg-based steelmaker Arcelor by India's Mittal Steel, increasingly, decision-making and opinion-shaping take place more in the global financial centers and not necessarily where companies are headquartered or have factories. If Mittal's target had been Nippon Steel, for example, then for sure the Japanese steelmaker's fate would have been decided in the boardrooms of pension funds, hedge funds or investment banks in London or New York, but certainly not in Tokyo.

Japanese financial institutions are being largely left out of global merger and acquisition activities, adding to their already low levels of competitiveness. A key factor in Japan's inability to compete effectively in the international financial sector is the lack of sophistication in the country's domestic financial sector. This has meant that Japan's financial institutions have little incentive to hone those skills necessary

MEDIOCRE EXPECTATIONS YIELD LACKLUSTER RESULTS

Scorecard of main measures and objectives set in 1996.

1. Liberalization of international capital transactions	Achieved
2. Product liberalization (securities, investment trusts, derivatives, etc.)	Achieved
3. Deregulation of cross-sector entry among banking, trust, securities and insurance sectors	Partial
4. Removal of the ban on financial holding companies	Achieved
5. Liberalization of fixed brokerage commissions	Achieved
6. Harmonization of accounting standards with international practices	Partial
7. Stricter disclosure rules for banks and securities firms	Achieved
8. Creation of safety net for securities and insurance firms	Achieved
9. Creation of the Financial Services Agency	Achieved
10. Full revision of the BoJ Law (increased central bank independence)	Achieved
11. More rules-based style of financial administration	Partial

SOURCE: AUTHOR

to compete internationally with their global peers in the most advanced markets. Furthermore, underdeveloped domestic markets means that Japanese financial firms lack the scale and profitability levels that would allow them to play an active role in global consolidation.

Why has Japan missed this opportunity to mold itself into a powerhouse of global finance? Is it, as some commentators would have it, due to some inherent inability of the Japanese to be successful in risk-taking activities? Hardly. After all, it could be said that one of first types of financial derivatives originated in Japan when, in 1710, the Dojima Rice Exchange in Osaka introduced rice warehouse receipts that could be actively traded against future deliveries. In addition, the underlying mathematical theory behind the pricing of options was introduced in Japan in 1942 by the Japanese mathematician, Kiyoshi Ito.

If not cultural, then the problem must be related to the action (or inaction) of other players in Japan's financial sector. For one, Japanese regulators surely must shoulder their share of responsibility. The stated Big Bang goal of furthering competition by promoting cross-sector entry among the

various fields of banks, trust banks, securities companies and insurance companies has yet to be realized. Today, the constraints between banking and insurance, and between banking and securities remain considerable.

Neither are Japan's bureaucrats beyond reproach. The ministries have, in general, been too slow, overcautious and uncoordinated in their approach to implementing the reforms. Yet to be fair, the bureaucrats were often just answering to elected politicians and the

political agenda of the day—agendas that were at times contrary to the spirit of the Big Bang. Japanese politicians' main failure has, in effect, been their inability to retain the grand vision that was set forth in 1996, and which should have been maintained as the guiding light when formulating new deregulation measures or when implementing regulations aimed at correcting perceived systemic weaknesses. This breakdown stands in sharp contrast to the bipartisan ideological consistency that was sustained during the implementation of the British Big Bang.

Finally, the media can also be faulted for its complete lack of perspective in embracing the cause for financial reform. It jumped on any phenomenon that could be seen as promoting the cause without much meaningful analysis, only to reverse course ostensibly when duped, deluding the general public to believe that the reform was the cause of all this chaos. This was never more visible than during the recent scandals involving Takafumi Horie and Yoshiaki Murakami, where both men went from zero to hero and back to zero in a very short period of time. Of course, a more appropriate starting point would be

for the media to educate the public on developments in finance—both the benefits and potential pitfalls. Perhaps even more importantly, the media should perform its true function by holding the country's politicians, bureaucrats and private-sector corporations accountable, and ensuring that all parties maintain momentum for reform.

Time Waits for No Man

IN ADDITION TO the factors outlined above, there is one more point that cannot be stressed enough: The world does not stand still and any reform plan needs to reflect that reality. Clearly, Japan's financial reforms initiatives did not (and still do not). During these past 10 years, there has been explosive growth in the world's financial markets (despite the burst of the Internet bubble) on the back of increased globalization, and the emergence of new markets in China, Russia, India, Brazil, South Africa and the Gulf States. These forces, combined with an unprecedented funding need in the U.S. to finance the war on terror, have contributed to a global reflationary situation which has fed all the world markets, especially commodities markets.

If Japan could only muster a lackluster, slow and merely partial reform package in the context of a fast-changing world, then it is not surprising the package could never have been sufficient to ensure Japan a leadership role in global finance. Not just that, but the lack of proactive reform and ambition to set the global standards means that Japan may have to struggle just to retain its current position as Asia's leading financial hub in the face of mounting challenges from China, among others.

In the Five Year Plan covering 2007-12, China's National Development and Reform Commission is planning to promote the displacement of manufacturing from the Eastern seaboard to deeper inland in

order to minimize inequalities and bring the factory jobs closer to those rural areas with excess labor and to ensure better living standards in coastal regions. As a result, China will need to develop its service industry in the same coastal regions if employment levels are to be maintained. Assuming a fully convertible yuan and further market liberalization, it is likely that the financial industry will enjoy exponential growth benefiting Hong Kong (the crossborder gateway) and Shanghai (for the domestic market). From a regulatory perspective, these two markets could become joined at the hip. Singapore will also benefit by providing offshore convenient private banking and asset management services for this growing Chinese wealth, becoming a kind of "Switzerland of Asia."

In order for Japan to benefit from this trend, it needs a truly coordinated strategy by which all unachieved goals of the Big Bang (cross-sector entry, accounting harmonization, rules-based regulation, etc.) are swiftly implemented and by which a new set of ambitious objectives are set for the next five years. Failure to do this will probably mean that Japan will lose its regional leadership in the next five to 10 years. A faster adaptation to global change is also necessary, if Japan really wants to achieve global leadership status. This is, in my view, essential if Tokyo wants its voice heard on global harmonization talks and as it seeks parity with China when starting to forge greater economic and financial integration with Asia. Without this parity, any integration will rather become an aggregation around China, with Japan reduced to a vassal role or left out completely as an outsider in the region.

Such are the stakes for Japan that Prime Minister Abe should take direct leadership in formulating this new financial reform strategy and ensuring appropriate coordination. ■



The Geopolitics of Asian Cyberspace

by Ronald Deibert



WHAT HAPPENS TO your request when you click on a link to a Web site or send an email? For most surfers, the Internet experience begins and ends with what happens on the computer screen in front of them. However, if you follow that email or Web request as it leaves your computer and passes down the fiber-optic cable to the servers and routers of your local Internet Service Provider (ISP), through the Internet Exchange Points (IXPs), international gateways, and on to the undersea trunk cables of telecommunications companies, you will find a complex and largely hidden infrastructure of filters and choke points.

Conventional wisdom had it that the Internet was an unstoppable force for liberalization, with nondemocratic states powerless to control this sprawling, seamless network of networks. But this vast international “underbelly” of the Internet—almost completely invisible to most Internet users—has become an object of geopolitical contestation among states, and a site where political power is being asserted.

Perhaps nowhere is the geopolitical dy-

namic playing itself out more forcefully than in the vast region of Asia. Home to one of the world’s cyber-superpowers, China, and dozens of newly emerging markets eager to capitalize on the benefits of new information and communication technology (ICT) while limiting negative side-effects for centralized political authority. Sophisticated ICT companies, many from the West, are following the lead of Asian governments, offering a wide range of appropriate products and services.

This exercise of political power in cyberspace by states in Asia, however, is not going uncontested. A swarming resistance movement of tech-savvy citizens is forming to protect the Web as an unfettered forum of freedom of speech and access to information. With the development of new software tools designed to circumvent censorship, they are taking the battle to the Internet’s inner core.

Mr. Deibert is director of the Citizen Lab at the Munk Centre for International Studies at the University of Toronto, and a principal investigator of the OpenNet Initiative. The psiphon software can be downloaded from <http://psiphon.civisec.org/>.

Perhaps the best window on the dark underbelly of the Internet comes from the research of a project I direct: the OpenNet Initiative (ONI)—a collaboration among the Citizen Lab at the University of Toronto, the Berkman Center for Internet & Society at Harvard Law School, the Cambridge Security Programme, the Oxford Internet Institute, and partner NGOs worldwide. The aim of the ONI is to document empirically patterns of Internet censorship and surveillance worldwide using sophisticated means of technically interrogating the Internet directly. The ONI's tests are carried out both remotely from North America and the United Kingdom, and in the field by dozens of local researchers. Our reports over the last several years have documented a disturbing increase in the scale, scope and sophistication of Internet censorship practices worldwide, including in Asia.

When the ONI was formed in 2002, only a handful of countries were known to engage in Internet content filtering, most prominently China, Iran and Saudi Arabia. Now more than four years later, the ONI is presently testing in more than 40 countries worldwide. China is still the world's most notorious and sophisticated censoring regime. Its filtering system comprises multiple levels of legal regulation and technical control, the latter implemented primarily at the backbone level using specially configured Cisco routers. The system involves numerous state agencies and thousands of public and private personnel, and a dense web of ever-thickening legal restrictions.

However, China is not alone. Among countries that the ONI has researched in Asia, we have technically confirmed Internet content filtering in Burma, Vietnam, the Maldives, Thailand, South Korea, Singapore, Pakistan and India. Although we have not yet conducted tests in North Korea, it is well known that what little Internet exists in the country is heavily filtered. Likewise, Australia filters Web content through offi-

cial takedown notices issued to ISPs by the government. In Central Asia, we have also identified extensive Internet censorship practices in Uzbekistan, and intermittent or targeted filtering in Kazakhstan, Kyrgyzstan and Tajikistan.

Mission Creep

ALTHOUGH MANY COUNTRIES justify their censorship practices as a way to block access to pornography or other culturally sensitive material, our research has documented a large and growing swath of content beyond pornography that is targeted for filtering.

In China, Burma, Uzbekistan and Vietnam, for example, ISPs routinely filter access to the Web sites of local opposition parties, dissident and independence movements, and human-rights and religious groups. Free email, Web-hosting, and blogging services; online encyclopedias (such as the popular Wikipedia, in the case of China); privacy and security tools; and instant messaging clients are also targeted for filtering. Other countries appear to be following this path. In Thailand, for example, what started out as an effort to block pornography has been gradually broadened to include politically-sensitive Web sites as well, particularly since the September 2006 military coup. Pakistan began filtering sites that contain imagery offensive to Islam, and now targets sites related to the Balochistan independence movement as well. The Thailand and Pakistan cases may suggest that once the tools of censorship are put in place, the temptation for authorities to employ them secretly for a wide range of ulterior purposes may be large—particularly in circumstances where there is little civilian oversight or accountability—a phenomenon we refer to as Internet censorship “mission creep.”

The ONI has also documented a more concentrated effort among states to target

content in local languages, such as Vietnamese, Mandarin, Arabic and Farsi. For example, our in-country tests in China compared search results for keywords in both English and Chinese and found a much higher rate of inaccessibility for contentious Chinese keywords. Phrases such as “Chinese Labour Party,” “China Democracy Party,” “Party for Freedom and Democracy in China,” and “Inner Mongolian People’s Party” are less likely to be accessible in Chinese than English. The same variation rates of inaccessibility were also found in Vietnam and Iran. Although determining the motivation for such variation is difficult, one might surmise that political authorities may want to target that web content which hits closest to home while leaving English speaking visitors to the country (e.g., journalists, Western human-rights activists) with the impression that censorship is rare.

The increased sophistication of Internet content filtering practices can be attributed, in part, to the services provided by Western (mostly U.S.-based) software and Internet service firms. Whereas once the best and brightest of Silicon Valley were associated with wiring the world, and opening up access to vast stores of information, today they are just as likely to be known for doing the opposite. Although Microsoft, Cisco, Yahoo!, Skype, and Google have all come under scrutiny for colluding with China’s Internet censorship practices, perhaps the most significant, serious, and yet overlooked contribution to Internet censorship by Western corporations comes from the manufacturers of the filtering software used to block content.

Internet security companies like Forti-

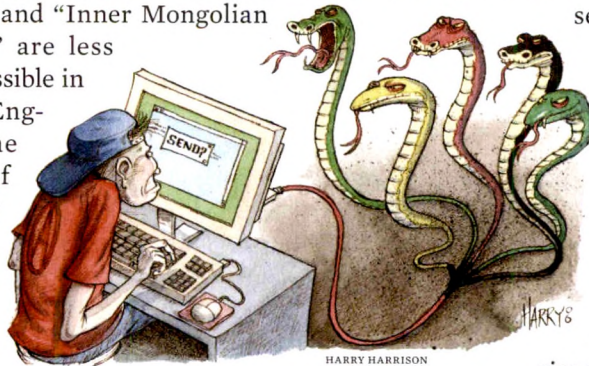
net, Secure Computing and Websense create off-the-shelf filtering products that block access to categorized lists of Web sites. While these products are primarily marketed to businesses, they have been readily employed by censoring states like Tunisia (Secure Computing), Iran (Secure Computing), Burma (Fortinet), and Yemen (Websense) to block access to politically sensitive content.

Just like businesses that do not want their employees to view gambling or sport sites on company time, these governments simply tick off those categories of Web sites they do

not want their citizens to access, such as “advocacy groups” or “militancy and extremist groups”—two categories in Websense’s database. The former is defined by Websense as “sites that promote change or reform in public policy, public opinion, social practice, economic activities and relationships,” while the latter is defined as “sites that offer information about or promote or are sponsored by groups advocating antigovernment beliefs or action.”

Digital Deceit

ONE TROUBLING TREND identified has been the lack of accountability and transparency over Internet-content filtering practices by states that censor. While there is certainly a legitimate debate to be had about the balance between a state’s right to cultural sovereignty and the free flow of information, unfortunately most states do not allow such a debate to take place prior to filtering, and have been shown to be deceitful about the content they block and the filtering practices they employ.



While some authorities yield clearly labeled blockpages to users who request banned content, others are not so transparent. In China, for example, ONI researchers found through forensic analysis that China's backbone routers are configured such that requests for banned content result in a network timeout error. The routers then send packets to the user's machine effectively blocking that user's unique IP address for an indefinite period of time such that any further requests for any web content on the same server results in a network timeout error. Among some ISPs in Uzbekistan, requests for search engines or political opposition Web sites are redirected to search engine Web sites. In Tunisia, "spoofed" Web sites are returned instead of blockpages to give the appearance of network errors instead of deliberate filtering. In Kyrgyzstan and Belarus, ONI researchers found troubling patterns of inaccessibility to opposition Web sites during election periods in each of those countries—inaccessibility we traced to denial of service attacks or what appears to be deliberate tampering with domain name servers. The latter cases suggest a new form of "just-in-time" filtering which is less easy to verify or attribute responsibility but just as effective in blocking access to politically sensitive sites. The authorities leave the Internet open, in other words, but turn the tap off only at critical periods, such as during elections or public demonstrations.

Adding to problems concerning lack of transparency and accountability is the use of proprietary filtering software outlined above. The manufacturers that make the commercial products used to block access to information treat their blacklists as trade secrets, revealing only general categories or sample Web sites to the public. This combination of proprietary software tools and nondemocratic regimes creates a kind of double bind of unaccountability.

Protecting the Net

PERHAPS THE MOST powerful way to protect the net, however, is by taking the battle to the underbelly of the Internet itself—by creating technologies that help secure, rather than undermine—access to information and freedom of speech.

At the Citizen Lab at the University of Toronto, our contribution comes in the form of a simple censorship circumvention program called psiphon, released on Dec. 1, 2006. The software works by having people who live in uncensored countries, like Canada or the U.S., install a psiphon server on their home computer, and then give the connection information to a few friends or family members that live inside censored countries. Because each psiphon node runs separately on private computers, and the connections among psiphon users and servers are encrypted, it is extremely difficult for authorities to block.

Psiphon will allow individuals to bypass their government's filters, and connect to the Internet the way it was originally meant to be experienced. Rather than set the bar at the lowest common country denominator, psiphon sets it at the highest, most open Internet standard, allowing individuals themselves to determine what information they can or will not access, rather than deferring such a choice to bureaucratic elites. Yet psiphon and other similar software are not magic bullets that will end Internet censorship once and for all. The job of preserving the Internet as an open global commons of information is a constant cat and mouse game between citizens who want access to information and authorities that want to control and limit it.

But even so, these grass-roots technological efforts—that shore up the Internet's infrastructure as a medium that supports, rather than detracts from, human rights—may be citizens' best weapons in the ongoing geopolitical battles over cyberspace. ■



The Lombok Pact's Empty Promise

by Hugh White

CLOSE NEIGHBORS ARE seldom close friends, and Indonesia and Australia are no exception. Twice in recent years, Jakarta and Canberra have tried to put their complex and often troubled relationship on a more robust footing by signing formal security agreements. The first time was in late 1995, when then Australian Prime Minister Paul Keating and then Indonesian President Suharto concluded an "Agreement to Maintain Security" between the two countries. It lasted less than four years. Now the two sides are trying again. On Nov. 13, 2006 Indonesia's Foreign Minister Hassan Wirayuda and his Australian counterpart Alexander Downer signed an "Agreement on the Framework for Security Cooperation" on the Indonesian island of Lombok. The new agreement is very different from the last one, but it is likely to end the same way: It will raise unrealistic expectations which will lead to bitter disappointments, making the relationship more, not less, vulnerable to shocks and crises. Without deeper work on the fundamentals of the relationship from both sides, agreements

like the one signed in November are worse than useless.

To see why this is so, it helps to explore the origins of the two agreements. The first security agreement between Jakarta and Canberra was an Australian initiative. Mr. Keating saw it as a way to crown his personal diplomacy with Mr. Suharto by decisively redefining the Australia-Indonesia relationship. Australia would no longer seek security *from* Indonesia but *with* it. His officials modeled the initiative on the kind of traditional security treaties that Australia had signed with global and regional allies such as the United States, Malaysia, Singapore and Papua New Guinea. None of this had much attraction to Indonesia at that time, and indeed it seemed contrary to Indonesia's long-standing policy of nonalignment. But with Mr. Suharto's personal backing the two governments went along with it. Behind this acquiescent

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attitude lay a certain nonchalance: In the mid-1990s Australia did not loom very large in Indonesia's security calculations one way or the other. It was Australia that worried about Indonesia, much more than vice-versa.

That changed in 1999. Australia's activism on East Timor that year surprised, alarmed and wounded the Indonesians. Australia was blamed for Indonesia's humiliating loss of territory, and the 1995 security treaty was ripped up in response. But that was not the end of it. After 1999, a surprisingly deep residue of distrust of Australia remained in Jakarta. A widely held view emerged that Australia had somehow deliberately engineered the independence of East Timor and international armed intervention there to humiliate Indonesia at a moment when Indonesia was weakened by economic and political turmoil. It came to be believed by some that Australia's support for East Timor was part of a plan to expand its sphere of influence into Eastern Indonesia. It became something of an article of faith among some Indonesians that under this plan Australia had designs on the Indonesian province of Papua as well, and aimed to support separatism there, building international support for Papuan independence, and even (according to some) planning a military intervention there.

Of course this is all quite untrue, but it has been lent credibility by the shrill anti-Indonesia sentiments expressed by Australians, including the government, in 1999, by the triumphal tone of Canberra's rhetoric about Australia's "liberation" of East Timor in the years since 1999, and by the development since 1999 of a wider pattern of Australian intervention in its immediate neighborhood. More sensible people in Jakarta—including most likely President Susilo Bambang Yudhoyono himself—probably discount the more extreme suspicions, but they do fear that

Canberra might come round to support Papuan independence if pressure from public opinion at home and abroad builds up in future. That, after all, is what happened with East Timor.

The result has been that, over recent years, some Indonesians have come to see Australia as a threat to their country, in a way they never did before. This is the reason for the new security treaty. Unlike the earlier treaty, this one has been an Indonesian initiative. It was first proposed by President Susilo Bambang Yudhoyono shortly before his visit to Australia in April 2005, and it has been pushed through this year after a crisis in relations over Papua early in 2006, when Australia granted refugee status to a group of Papuan independence activists. This raised fears in Jakarta that Australia was moving to support the separatist movement, bringing all of Indonesia's post-1999 anxieties about Australia to the surface. The centrality of this issue to Indonesian concerns is perfectly evident in the text of the document itself, which focuses almost entirely on "the principles of good neighborliness and noninterference in the internal affairs of one another." The text runs to nine pages, but much of it is verbiage. In the only substantive provision—Article 2.3—the two sides promise "not in any manner [to] support or participate in activities by any person or entity which constitutes a threat to the stability, sovereignty or territorial integrity of the other party, including by those who seek to use its territory for encouraging or committing such activities, including separatism, in the territory of the other party." These of course are the norms codified in the Association of Southeast Asian Nations' Treaty of Amity and Cooperation. To find a model for the 1995 Security Agreement, Australia turned to its strategic traditions, like the Australia, New Zealand, United States Security Treaty, and the Five Power Defence Arrange-



Australian Foreign Minister Alexander Downer and his Indonesian counterpart Hassan Wirayuda after signing a bilateral security treaty in Lombok on Nov. 13, 2006.

ments, while Indonesia turned to its very different traditions in Asean to find models for the second Security Agreement signed in November.

But this new effort is as equally doomed as its predecessor. The new security agreement is based not on trust and a sense of shared interests, but on mistrust and suspicion. And there is no likelihood that Australia, for its part, can or will fulfill the obligations it has undertaken under the new treaty. Clearly Indonesia hopes and intends that by agreeing to the terms quoted above, Australia has agreed not to allow Papuan separatists based in Australia to campaign for independence. But on the evidence of recent years, no Australian government from either major party would be prepared to act decisively to stop Papuan separatists, or other Indonesian dissidents, from campaigning in Australia. As was evident when the Papuan refugee issue blew up early in 2006, Australian public opinion remains suspicious and even hostile towards Indonesia, and highly sensitive to any suggestion of Indonesian pressure on Australia on such issues. Prime Minister John Howard, having achieved his greatest triumph as prime minister by being seen to stand up to Indonesia over East Timor, is the last person who wants to be seen to bend to Indonesian pressure.

The truth is that Indonesia is right to worry that an Australian government, whatever it says now, would find it hard to resist domestic and international pressure to swing support behind Papuan separatism, if momentum in that direction were to grow in future. At present that seems a distant prospect, but the issue remains a serious focus of risk in the relationship. And in the meantime the likelihood of smaller incidents between Canberra and Jakarta over Papua is high. The next time a group of Papuans seeks asylum in Australia, for example, Indonesia will expect Australia to send them back to Jakarta in accordance with the new treaty. Canberra will be under great public pressure not to do so. If it caves into that pressure, Indonesia will be bitterly disappointed and may tear up this treaty as well. The treaty thus becomes, like its predecessor, not a symbol of the relationship's strength, but of its fragility.

Both sides are to blame for this. Indonesian attitudes to Australia are somewhat paranoid and ill-informed, but Australian attitudes to Indonesia also remain overshadowed by misunderstandings about events in East Timor in 1999. Australians remain woefully ignorant about, and uninterested in, Indonesia's remarkable democratic transformation since Mr. Suharto's fall in 1998. And the long tradition in Australian politics of bipartisan support for a close relationship with Indonesia has been replaced by edgy tactical point-scoring on both sides. No political party in Australia is prepared to take political risks or pay political costs to put the relationship with Indonesia on a stronger footing. Until that changes, the relationship will remain vulnerable to periodic crises that the new security agreement will be powerless to manage. ■



The Morass In Mindanao

by Greg Rushford



VISITOR TO ZAMBOANGA is immediately struck by its beauty. With surrounding lush mountains, palm-lined streets silhouetted by mosques and also Catholic shrines, leafy plazas and architectural gems dating to 17th century Spanish conquistadores, this bustling port city has long been dubbed Zamboanga Hermosa: beautiful Zamboanga. The very name suggests timeless romance. But it has also been the setting for centuries of violence pitting Christians against Muslims.

Across the Celebes Sea is the shadow of Basilan, the entry point to the deep waters surrounding the violence-plagued islands of the predominantly Muslim Sulu Archipelago. Fishermen, smugglers and assorted traders with their bancas have always plied the trade routes to nearby Malaysia and Indonesia, paying scant heed to national borders. Southern Thailand, another “high threat” area in the global war against terrorism, is just across the South China Sea. In the five years since September 11, the region’s national-security stakes have become increasingly important beyond Southeast

Asia. Japan recently announced its participation, along with Brunei and Libya, in a Malaysian-led international monitoring team watching over a cease-fire agreement struck three years ago between Moro rebels and Philippine President Gloria Arroyo. China, which also has an interest in stability along sea lanes of crucial importance to international trade, is watching. And in this post-Cold War era, America’s traditional security interests in the Philippines, along with humanitarian concerns, increasingly run through Mindanao.

The good news is that while the issues that divide the Philippine government and the Moro Islamic Liberation Front remain difficult, they do not seem to be intractable. It is possible to imagine a peace deal being struck, despite recent headlines. The chief sticking point involves MILF demands for control of their “ancestral domain” lands. Although the MILF claims to have some 11,000 armed fighters on call, the 2003 ceasefire has held, despite sporadic

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violence that each side blames on the other. Both sides these days seem to prefer peace to fighting that has cost 100,000-plus lives since the 1970s, while uprooting more than a million villagers.

The bad news begins in Manila, with the fact that Ms. Arroyo's government is widely regarded as corrupt and ineffective. Having survived several military coup attempts and two congressional impeachment attacks, the embattled president lurches from one political crisis to another. There seems to be little time for the serious business of economic reform, or negotiating peace. Moreover, the prospects are dim that even a successful peace accord would spark the kind of economic growth that the Philippines so desperately needs.

"If a peace deal is struck, Mindanao would still be in the same boat as the rest of the Philippines," observes Steven Rood, the Asia Foundation's top man in Manila. Sadly, this metaphorical boat is an extremely leaky economic and political vessel.

Mindanao is a natural Asian trading entrepot. "In the late 19th century, Sulu was the center of trade with China," says Ishak Mastura, a 34-year-old rising Muslim lawyer from Cotabato City. "We Moros are not afraid of free trade and we are not afraid to compete." In General Santos City, the tuna capital in the southernmost part of the island of Mindanao, I hear constant complaints that high American and European tariffs on canned tuna are holding Philippine tuna exports back. Tear down those tariff walls, we want trade, not just

aid, the refrain goes. That's certainly not true in Manila.

The Philippine economy, traditionally dominated by an insular business elite, is rife with protectionism and corruption. Ms. Arroyo's priorities in international trade negotiations are not to lower tariff walls that hold Philippine exporters back, but to insulate the Philippines' uncompetitive industries: chickens, rice, sugar, on-

ions, and more. Senate majority leader Francis Pangilinan summed up the economic thinking in elite circles when he told reporters on Aug. 7, "We need to think long and hard before we liberalize further our economy and industry."

One issue that unites Muslims and Christians in Mindanao is a mutual belief that the island's economic development has long been hampered because of a neglectful "imperial Manila." In the absence of the kind of major economic reforms that would allow Mindanao's entrepreneurial energies to flourish, the Philippines' southern island is still something of an economic hostage.

A Shipping Mess

PEACE DEAL OR NO, it will still be cheaper to ship corn from Seattle to Manila than from Mindanao to Manila. One businessman from Mindanao, who ordered machinery from Japan, complains bitterly that the costs of shipping the machinery from Manila to Mindanao on a Philippine shipping line were double the costs of get-



ting the machinery put on a Japanese ship from Tokyo to Manila. Because of the Philippines' cabotage law, which prohibits foreign vessels from carrying goods from one domestic port to another, the machinery could not go to Mindanao from Manila on the Japanese ship it had arrived in.

Says Amina Rasul, a key mover in the Philippine Council for Islam and Democracy and a Manila Times columnist: "The costs attendant to shipping are so expensive, if you are a small businessman, you would die." I heard practically the same words from Celso Lobregat, the mayor of Zamboanga City, and from General Santos's mayor, Pedro Acharon Jr.—and also from well-placed members of the Arroyo administration. Everyone agrees there is a serious problem. But nobody seems to agree on even the root causes for the infamously high shipping costs, much less what to do about them.

Some observers charge that the domestic shipping lines are cartel-like oligopolies, controlled by a few politically powerful families. "I can't prove they operate like a cartel, but when there is an increase in freight costs, all the companies follow in line," one businessman from Mindanao told me. But shipping industry sources vehemently deny suggestions of collusion, insisting that they compete vigorously with one another. Still other observers say the blame is not with the shipping industry, but with the government-owned ports, which are notoriously corrupt and inefficient.

Plenty of economic problems have nothing to do with the shipping industry, such as the lack of decent roads. And while Philippine corn farmers hope to hide their inefficiencies behind high tariffs and quotas, they keep on loading their corn in individual containers, which is a very expensive mode of shipping. Apparently small farmers haven't figured out how to band together and ship in bulk.

The high shipping costs ripple upwards,

to the detriment of the national economy. Because it's so expensive to ship corn feed, the chicken industry faces prohibitive costs—and, like the corn lobby, also tries to protect itself with trade barriers that limit import competition. This protectionist pecking order translates into expensive chickens that hold back Philippine restaurants and punish Filipino consumers.

Ms. Arroyo has begun to tinker at the edges of the mess with a program for a "nautical highway," the idea being that cargo could roll-on and roll-off ferries at the most convenient available landing, thus avoiding the government's own ports and high-stevedoring costs. Just to launch Ro-Ro, as it has been dubbed, the Philippine transportation department has had to coordinate with 18 of its subordinate agencies since 2003, plus coordinate efforts with at least five other major departments including the department of public works and the national economic development authority. Talk about a daunting bureaucratic challenge.

'Super Maids'

THE PHILIPPINE GOVERNMENT is projecting economic growth of more than 5% for 2006, up a few notches from last year, and also points to 22 consecutive quarters of economic expansion. But savvy investors will not necessarily be reassured.

Philippine economic growth this year will be fueled by some \$12 billion in remittances sent by an estimated eight million overseas Filipino workers—roughly 12 times the amount of foreign direct investment the Philippines attracts in a good year. The economic drivers are not the Philippine business elite. They are maids in Hong Kong and Singapore, mechanics in Saudi Arabia, and doctors and nurses in California.

A recent PulseAsia Inc. survey reported that three out of ten Filipinos "would

now migrate if it were only possible." The Philippines' most successful export is the country's own resourceful people. Rather than being shamed, President Arroyo has boasted of her administration's intention to train even more "Super Maids."

It also appears that the Manila authorities have little shame when it comes to discouraging foreign investment. The shells of failed construction projects are scattered around the capital city. One of the first things any visitor sees is the never-used Terminal Three at Ninoy Aquino International Airport. The building was to have been a shining example of how the Philippines could work with world-class German and Japanese firms. Then, with the terminal nearly completed, President Arroyo announced that the construction consortium's contract was invalid, throwing it out of the terminal and launching expropriation proceedings. In August, a Singapore-based arbitration panel ordered the government to turn over the terminal to PIATCO. It still hasn't, although Ms. Arroyo and her lawyers seem to be running out of legal maneuvering room.

The latest sneak attack against foreign investors came on Aug. 11, when President Arroyo issued an executive order designed to end a Malaysian firm's development of oil deposits off western Palawan. Outraged officials with Malaysia's Mitra Energy Ltd. complained that they had had spent more than \$1 million so far in the preliminary stages of what was to have been a \$700 million project. There was no explanation from the presidential palace.

To be sure, Ms. Arroyo didn't invent crony capitalism and foreign-asset grabs. "What I think is new is they don't care anymore about what foreigners think," says Norbert Garrett, who runs the Philippine operations of Kroll Inc., the global risk consultancy. According to the American Chamber of Commerce, within ASEAN foreign direct investment was \$38 billion

last year, of which the Philippine share was \$1.1 billion—only 3%.

Meanwhile, the Philippines' longstanding "red tape" problem isn't getting any better. The World Bank's most recent report ranking governments on the ease of doing business shows Singapore as No. 1, followed closely by other Asian star performers Hong Kong (5), Thailand (18), Korea (23), and Malaysia (25). The Philippines was 126, down five notches from last year, and behind even Bangladesh (88) and Vietnam (104.) This year, Ms. Arroyo vowed to make a campaign against red tape a top priority. She has said much the same each year since 2001. Lately, the president has fallen back on spin, boasting that a survey by the respected Social Weather Stations turned up evidence that bribery to win government contracts in Manila has fallen to "only" 46% from 57% in 2003. Ms. Arroyo doesn't add that the same survey showed that confidence in the presidential office has plummeted.

Misperceptions and Neglect

APPRECIATING THE DIFFICULTIES that divide "Muslim" Mindanao from "Catholic" Manila basically comes down to differences in attitudes between the two that have nothing to do with religion. The first misperception begins with demographics. Although few Filipinos one meets in Manila seem to be aware of it, Mindanao isn't predominantly Muslim. Of the 85-plus million people in the Philippines' 7,100 islands, 81% are Catholics and 12% belong to other Christian denominations. Maybe 5% of all Filipinos are Muslims. And of the estimated 16 to 20 million residents of Mindanao, perhaps four or five million are Muslims.

In 1996, then President Fidel Ramos negotiated what was to be a "final" peace deal with another Muslim rebel group, the Moro National Liberation Front. A so-called Au-

tonomous Region of Muslim Mindanao was created. Nearly 2.5 million Filipinos live in the ARMM, in the islands along the Sulu archipelago from Basilan to Sulu and Tawi-Tawi, and in central Mindanao in places like Cotabato, Marawi City, and Maguindanao. Ninety percent of ARMM residents are Muslim. More than three-fourths of these are desperately poor people without clean water and other necessities.

While many of the Muslims' problems traditionally have been self-inflicted—corrupt leadership, feuding warlords—probably the more important point involves a tradition of neglect from Manila. Neglect, and domination. The background is detailed in a secret 37-page cable sent in August 1974 by U.S. Ambassador William Sullivan to the State Department in Washington, D.C. tracing the root causes of the Muslim rebellion. The cable was drafted by John Forbes, a young foreign service officer who had traveled extensively in the region. It was recently declassified, and remains relevant to the situation today.

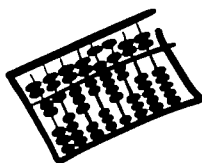
While “weak and discredited” Muslim leadership certainly played a role leading to the fighting, the cable noted, so did “thirty years of neglect of the Muslim community by the central government.” “As the population of the Maguindano area grew to more than one million, questions of land ownership became acute, with many parcels of rice and corn lands owned communally by Maguindano clans being transferred to Christian hands,” the Forbes-Sullivan document continued. “Slowly, the Maguindano saw themselves being pushed back onto inferior lands and becoming economically and politically disadvantaged vis-a-vis the Christians, who they felt had at least the tacit support of the central government.” As for U.S. policy, the cable concluded that America “would have everything to gain from a rapid and peaceful solution to the problem.”

Fast-forward to today, and that cable

still describes American policy. U.S. Special Forces, operating out of Camp Navarro in Zamboanga City, win praise from many Muslims for helping the Philippine military bring peace and order to places like Basilan, formerly the playground of the al Qaeda-linked Abu Sayaff kidnap-for-profit gang. When the Special Forces go into an area to help create a secure environment, they work closely with U.S. foreign aid officials, who build roads, schools and bridges.

“If America is able to help address the underlying historical grievances of the Muslim people of the southern Philippines, it would be another indication that we are willing to go to bat for people who have legitimate grievances,” says retired U.S. diplomat Eugene Martin, a former deputy chief of mission in Manila. Mr. Martin is now associated with the congressionally funded U.S. Institute of Peace, where he heads a Philippine “facilitation” project at the request of the State Department. The unstated idea is that the USIP’s independent status allows Mr. Martin more freedom to take up legitimate Moro complaints than American diplomats in Manila, who operate under the constraints of being formally accredited by the Philippine government.

However, in the meantime the string of broken promises from Manila continues uninterrupted. The ARMM is supposed to be autonomous, but it isn’t. The Muslim areas are without their own regional security forces. They cannot collect taxes for their local schools, and don’t even control their own budgets. The money comes from Manila. And what a pittance it is. “Funds appropriated by the national government to the Autonomous Region in Muslim Mindanao comprise 3% of the total national budget for the past 10 years—the second lowest allocation among the 15 regions in the country,” the *Moro Times* reported recently. And so the centuries of conflict in Mindanao keep rolling along. ■



Fuzzy Rules Make Bean Counters Mad

by Cathy Holcombe

IF ONE LISTENS to what accountants have been saying recently, one could almost get the impression that rules on financial statements hadn't been updated since the Romans. "When the basics of accounting procedures were written, the world's investors were more a private club than a global network. Auditors used fountain pens, capital stayed pooled in a few financial centers, and information moved by runner," the heads of six international accounting firms said in a jointly signed statement last month. "Business is now much more complex, with more sophisticated financial tools for raising capital and hedging risks than were available in previous decades....Yet the concepts governing financial reporting and auditing standards have not sufficiently changed with the times," the release stated.

This is an outstandingly cheeky bit of rhetoric. The rules are updated all the time—as they should be—but the process is neither easy nor pretty. Europe, in particular, implemented a series of striking reforms in the past few years, and the body

of rules it created—International Financial Reporting Standards (IFRS)—are now followed by more than one hundred countries. These rules of course include procedures for measuring and valuing "sophisticated financial tools." The sad fact is that the procedures are problematic, but they also seem to bring in lots of extra fees for accounting firms.

Here is one example of from Hong Kong which switched to IFRS this year. Locally listed Panva Gas took a big write off on an interest-rate swap under the new standards—then promptly cancelled the arrangement, fired its bankers, Morgan Stanley, then hired accountancy firm PriceWaterhouseCoopers as their new advisers. This is not to say the reforms are all some conspiracy to give business to accountants. But the attempts made thus far to classify and measure derivatives have proved costly and imperfect. In light of this, it is disingenuous to be babbling on about "protecting" investors with new up-

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grades in financial reporting procedures.

Take, for example, the standard known as IAS 32 (the acronym refers to International Accounting Standards), followed by companies in IFRS jurisdictions. This rule's job is to classify the nature of financial instruments. In that sense it is at the forefront of efforts to update reporting standards to reflect a more complex world. Unfortunately, after countless revisions since its original incarnation in 1991, the standard remains confusing, contentious and very possibly flawed. It will almost certainly be amended once again even though it was overhauled just three years ago. And most probably it will take years to implement any new round of revisions. Meanwhile, as the standard is currently written, it will cause billions of dollars worth of fluctuations in corporate earnings in jurisdictions that follow IFRS. It will also increase audit fees for companies with derivative products such as convertible bonds, and chase away bankers selling such products. Even accountants acknowledge its short-comings. "The current requirements often result in anomalies," Deloitte Touch Tohmatsu said in a newsletter it sends out to clients and staff.

The revised IAS 32 is one of many new accounting procedures that were designed—with good, reasonable intentions—to make financial statements reflect the current market value of their assets and liabilities. Historically balance sheets largely reflected what companies paid for assets, not what they were really worth in the open market. Moreover, when there were updates in the value, the changes remained on the balance sheet until the asset was sold. The new rules not only make IFRS-compliant companies constantly revalue their assets and liabilities—but in many cases the differences have to be added and subtracted to the income statement on a regular basis. The upside is more up-to-date financial statements. The downside is

increased earnings volatility. In Hong Kong the adoption of this rule coincided with a property boom—resulting in headlines blaring earnings increases.

(A story for another day is just how many Asian companies are now “playing the volatility” for short-term accounting gains amidst the current property boom in Asia, an unintended and risk-multiplying consequence of the rules.)

FOCUSING ON IAS 32, its largest impact for companies has been on the multibillion dollar convertible bond market—indeed, you could say it stabs right in the heart of this innovative but arguably high-risk method of corporate fundraising. A CB acts like a bond—paying interest in return for a loan—except that it also offers the holder the right to trade in the bond for shares in the company at a pre-agreed price. Previously (and as is still the case in the U.S.) the total value of the CB was put on the balance sheet like any other loan, as a liability. Under current IAS guidelines, the CBs are broken into two parts: the loan is treated as a liability and the option to convert to shares is treated as an “equity instrument.”

Here's where things start to get tricky. Under IAS 32, the equity portion of the CB (the option) can be redefined as a “financial liability” if it has certain features—features that are very common to CB structures. If this happens, then the changes in the fair value of the option must be dragged through the profit and loss statement.

Earlier this year Tianjin Development, a mainland Chinese company listed in Hong Kong, was surprised to learn that it fell into this zone. The “feature” that put it into “financial liability” territory was the fact that the company operates in China, and thus has revenues in yuan—but it is listed in Hong Kong, and its shares are priced in Hong Kong dollars. As both currencies could change in value, then theoretically

there is no "fixed number" of assets to be exchanged, which spelled severer accounting treatment for Tianjin Development. As a result, what would have been a 6% decrease in the firm's net profit for the first six months of this year, was instead caved into a 27% decrease. Tianjin Development injected what resembled a "minority opinion" into the text of its financial statements, decrying the rule as "unfair" and correctly pointing out that other overseas listed Chinese firms did not suffer the same treatment. "This [inconsistency] obviously makes it even more confusing to shareholders and readers of financial statements," the company wrote.

What Tianjin Development might not have known is that European companies faced the exact same problems when they implemented the revised IAS 32 standard a year earlier. Not only did various auditors interpret this passage of the standard differently, but bean counters within the same firm have haggled over its proper meaning. As a result, the International Financial Reporting Interpretations Committee (IFRIC), the body which adjudicates on hard accountancy questions, issued a temporary ruling last year in which it said that yes, sorry, but companies that are listed on overseas markets have to treat their CBS as derivatives if two separate currencies are involved. "Prior to this point it was known that different firms and different people had different answers," on the question, said Keith Pogson, a partner at Ernst & Young in Hong Kong.

Tianjin Development also might not have known that IFRIC had even specifically expressed "sympathy" to convertible-bond issuers in this situation. The committee has agreed to explore an amendment, but not to issue a temporary waiver in the meantime.

Firms might be more open-minded about fair value through P&L if it weren't for the way they are valued under IAS 39—

the dreaded companion standard to IAS 32. The problem is that the equity portion of CBS is valued according to standard options-pricing models, such as Black-Scholes. Options are basically two-sided bets: I bet a share is going down, you bet it is going up. There really can be only one winner.

But when companies issue convertible bonds, the situation is a more complex. Technically, as issuers, they are "betting" that the shares will fall under options-pricing theory. But companies obviously don't "lose" if their shares rise. Indeed, they win. One of the reasons companies issue CBS instead of new equity is that they want to sell the equity at a higher price further down the line.

Or let's say the company's shares tumble. This company potentially will book an exceptional gain on the CB—yet are they essentially "winners"? For starters, this means the bonds won't be converted so they have to come up with cash to pay back the bondholders, which could have negative cash-flow implications. More broadly, falling share prices generally are generally not a positive sign.

THIS INVERSE LOGIC does not, at a gut level, make sense for many companies. In the summer Chinese People Gas, another PRC company listed in Hong Kong, was gearing up to report a jump in profits for the first time since it had listed its piped-gas business. Unfortunately, weeks before the big day their auditors informed them that they had to write off \$15 million—or 75% of the value of a \$20 million convertible bond. They had to do this not because the money had somehow disappeared, but simply because the share price had rallied. The managers of the company delayed the results report by a month as they haggled with auditors over what they saw as a severe interpretation of the rules. Fights with auditors are considered red flags—

The problem in Hong Kong appears to be that no one out here seems to understand the rules.

one broker was quoted by Dow Jones Newswires as saying exactly this. The shares tumbled 14% after the results came out. If the rules were meant to protect investors, then they probably didn't feel too protected at this moment.

The revised IAS 32 was seven years in the making—and yet within months of its implementation a committee was set up to revise the standard once again. It could take years for all parties to agree on amendments. In the meantime, the effects have been controversial. In Europe, for instance, the rule has depressed the CB market in compliant jurisdictions. In 2002 and 2003, Europe issued \$73 million worth of CBS; from 2004 to 2005, in advance of the new rules (adopted in 2005 in the EU), issuance dropped to \$35 million, according to Dealogic. The CB market is famously volatile. In the U.S., which does not have a version of IAS 32 in its rules, saw issuance decline by 38% in the same period—but that is still much less than Europe's 52% free-fall. And this year the CB market in the U.S. is jumping—up 97% in the first nine months compared to just 16% in the EU.

In Hong Kong, the risk is that the local stock exchange will lose liquidity to China's domestic bourses as PRC companies gradually clue in to the implications of IAS 32. Many "H-share" companies have dual listings in China and Hong Kong. Thus they can get around severer accounting treatment by simply issuing CBS that convert into domestic "A shares"—two such companies have done exactly this in the past two months.

But at this stage, the problem in Hong Kong seems to be that no-one out here un-

derstands the rules. Hong Kong switched to an IFRS-only system this year, and as a result a wide array of fair-valuation-related changes hit all at once. Some of the new rules got a lot of attention, especially those concerning property revaluation. There were also major changes in how to account for goodwill, tax deferrals, stock options—it is no wonder that the minutiae in IAS 32 about CBS got lost in the crowd.

As I write this, I just finished reading an announcement from the Hong Kong Stock Exchange showing that a local retailer with a market cap of \$110 million, Hang Fung Gold, just issued a \$30 million CB. Not only was the conversion set at an ultralow premium of 4.22%—but if the shares fall, then the conversion price automatically resets to a price that is a fifth cheaper. "Reset" is just the type of feature that under IAS 32 will make its fair-value changes get put through the profit and loss. The low-down is this: unless Hang Fung's share price plummets, there will be a major fair-value blow to the EPS number next year. This is a lose-lose situation for investors.

You could say it's the responsibility of the companies to know the rules, whether or not they're perfect, and bankers shouldn't ignore them when hard-selling fancy derivatives products. But if the idea of reforming the financial statements is to "protect investors"—and that's what the six CEOs promised in their manifesto last month—then they have to dilute their idealism with a bit more practicality. Before bringing on new adjustments, the standard-setting bodies need to figure out a way to make sure everyone fully understands the changes. ■



Specter of Inequality Haunts Taiwan

by Craig Meer and Jonathan Adams



PAN DA-WU HAS fallen on tough times. Ten years ago, during the go-go 1990s when Taiwan's economy was still booming, he was a manager at a reshipment company, pulling in NT\$90,000 (\$2,745) a month. Now, to make ends meet, the 45-year-old father of one is driving a cab seven days a week, more than 12 hours a day, and barely manages to earn NT\$30,000 a month.

Mr. Pan blames his lot on his lack of skills, and the flight of the island's manufacturers to China. "If you are over 40 and don't have any qualifications, you're struggling," said Mr. Pan, whose wife left him a few years ago. "In the past, older people could get jobs in factories, but most of those jobs are gone now—all the companies have left for China. To support a family these days, you need to make more than NT\$50,000 a month, and most guys my age and with my qualifications find this nearly impossible."

Mr. Pan's case is hardly unusual in Taiwan these days—or for that matter, in other countries across Asia. In country after country, the gap between the richest and

the poorest is growing sharply wider, and the middle class is getting squeezed. Once-comfortable families are seeing real incomes erode, and watching as their slice of the pie gets ever smaller.

The International Monetary Fund's September Regional Economic Outlook for Asia notes that income inequality increased "dramatically" across Asia in the last decade. In that time, 13 out of 18 Asian countries posted increases in income inequality, as measured by the Gini coefficient. Ten out of 15 have a widening richest-poorest income gap, with South Korea posting the sharpest divergence. And a majority of countries are seeing a shrinking middle class, especially China and Sri Lanka.

Rising inequality is nothing new, but with the trend speeding up in recent years, the IMF and others are starting to sound an alarm about the dire implications for the region. "Economists have shown that countries that are more unequal are more likely

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to have social conflicts and ethnic tensions,” says the IMF’s Erik Lueth, a co-author of the chapter on inequality in the latest *Regional Economic Outlook*. Indeed, the two countries with the sharpest recent rise in inequality as measured by the Gini index—Sri Lanka and Nepal—are embroiled in a civil war and insurgency, and the number three country, China, is increasingly wracked with social unrest.

A widespread assumption is that the driving force behind growing inequality is globalization. But the IMF report challenges that view. It finds no link between trade openness and income inequality, and no effect on income inequality from net foreign direct investment flows. According to the IMF, technological change is a more likely cause for rising inequality across Asia. “Skill-biased technological progress represents a shift in the production technology that favors skilled over unskilled labor,” says the report. That process of technological advance would be happening regardless of the openness of a given country to foreign trade. In other words, says the IMF, don’t blame globalization.

Some dispute that conclusion, though. Political economist Robert Wade, from the London School of Economics, says the jury is still out on the link between more open trade and inequality. And he says the IMF has set up a false alternative of the cause of inequality (either more open trade, or technological progress), when the two may actually be linked. “Skill-biased technological change may itself be a result of greater openness,” says Mr. Wade. “I’m skeptical of the [IMF’s] explanation, because official agencies like the World Bank and the [International Monetary] Fund are always falling over backwards to deny that trade can have anything but benign consequences.” Moreover, the IMF’s finding conflicts with some other studies in the field. For example, while the IMF found that FDI did not worsen inequality, a study

published in 2003 by economists Rafael Reuveny and Quan Li concluded that inbound FDI did.

Tired-out Tiger

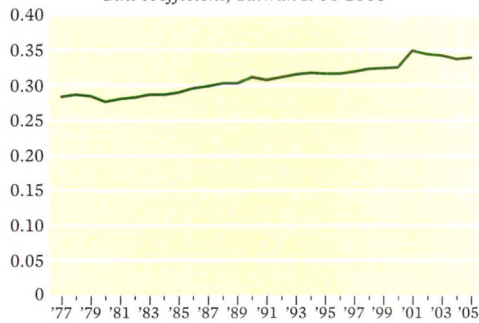
IS THE IMF right? To address that question, we turn to the case of Taiwan. Not so long ago, Taiwan was the poster child for equitable growth. From 1964 to 1980, it saw an export-led boom in which GDP expanded at an average of more than 10% per year and incomes actually became more equal—the Gini coefficient declined from 0.32 to 0.28 (a Gini coefficient of zero represents perfect equality and a coefficient of one represents perfect inequality). The island’s success in light manufacturing for export has often been cited by those singing the praises of globalization. Through trade, Taiwan’s pie got a lot bigger a lot faster, and everyone got a slice.

However since 1980 income inequality in Taiwan has gotten steadily worse. The Gini coefficient peaked at 0.35 when the tech bubble burst in 2000, and has only fallen slightly since, to 0.34. The richest 20% in Taiwan have seen their share of income rise from 36.8% in 1980 to 40.2% last year, while the share of the poorest 20% has fallen from 8.8% to 6.7%.

Ask economists and government officials what has driven Taiwan’s trend of growing inequality, and technological progress isn’t high on the list. Jack Hou, an economist at California State University, Long Beach, cites the narrative familiar to many on the island: As Taiwan’s manufacturing firms decamped to China in recent decades, less-skilled factory jobs went with them, pushing unskilled, middle-aged factory workers into jobs that paid less. The island’s skilled workers fared much better: A 2003 study by economists Lin Chun-hung and Peter Orazem, for example, found a persistent shift in demand toward skilled labor, with returns

TAIWAN'S CREEPING INEQUALITY

Gini coefficient, Taiwan 1964-2005



SOURCE: TAIWAN GOVERNMENT

for a college education rising from 1978 to 1996 for all but the least experienced college graduates.

For Taiwan, to focus only on technology is to ignore the 800-pound gorilla next door: China, whose own boom has sent shock waves through the island's economy. By shifting factories to China, with its lower costs for labor and raw materials, many of the island's firms actually avoided the need to upgrade their technology to stay competitive. Some firms moved entire operations across the Strait, pulling major suppliers along with them. "China has given many firms a second life," said Hung Jui-bin, from Taiwan's Council for Economic Planning and Development. "The wage costs in Taiwan are too high for a lot of companies and if they stay here they will face financial problems. So they go to China and, because the costs are so much lower, they can continue doing the same business with the same equipment."

That exodus to China was made possible by increasing capital mobility. In a 1995 case study of outbound FDI for the United Nations University, economist Nagesh Kumar noted that Taiwan relaxed previously rigid controls on outbound FDI in the late 1970s, and began to actively promote outbound FDI in the mid-1980s. At the same time, rising wages and a sharply appreciating New Taiwan dollar eroded the competitiveness of the island's ex-

ports—leading factory owners to cast their eyes abroad, especially to Southeast Asia. The result was a torrent of money flows out of Taiwan, with the stock of official outbound FDI surging to \$3 billion in 1990 from just \$26 million in 1975.

And that was just in the beginning. Taiwan began to approve official China-bound investment in 1991, and China itself became more open to foreign money later in the 1990s. By last year, approved outbound FDI stocks from Taiwan hit \$91.7 billion, with more than half of that (\$47.2 billion) going to China. And that last number is thought to vastly undercount real flows: This year the government guessed that Taiwanese had invested a staggering \$150 billion in China since the 1980s, if unapproved and indirect flows are included.

That massive stream of money out of Taiwan mirrors the larger global rise of footloose capital and often volatile money flows. For political reasons, and to avoid overdependence on one market, the Taiwanese government has tried to stanch the flow of investment to China, but with scant success. Taiwanese firms have simply routed investment through shell companies in third locations such as the Cayman Islands and Hong Kong, doing an end-run around the island's financial regulators.

Many in Taiwan—particularly those with pro-independence leanings—blame the flight of Taiwanese investment to China for a host of the island's economic ills, including rising inequality. "The Taiwanese firms that invest in China are often not expanding into China, but leaving Taiwan and relocating completely," said David Hong, president of the Taiwan Institute of Economic Research. "When they leave, they take important human capital with them and that is a net loss to the Taiwanese economy."

However, Taiwan's investment in China is just the most glaring example of a broader trend of huge outflows that began in the

Unless they can find a way to tame rising inequality, Asian leaders are likely to see more citizen fury.

1980s—at the same time that Taiwan began its two and a half decade trend toward greater inequality. Perhaps Taiwan's unique relationship and proximity to China make it a special case. But South Korea similarly relaxed outbound FDI controls in the mid to late 1980s, and saw rising inequality a few years later—a trend that spiked sharply after the capital flight of the 1997 East Asian Financial Crisis and has continued to increase rapidly.

Of course, two coincidental trends—higher FDI outflows and growing inequality—do not prove a causal link. And the IMF is not necessarily wrong to cite skill-biased technological progress as one cause of rising inequality across a broad swathe of Asian countries. But in the specific case of Taiwan, that explanation is at best too simple, and at worst misleading. For Taiwan, the circumstantial evidence is compelling: technology looks like just one piece of a puzzle, and likely a minor one at that, with the relaxation of capital controls and flight of corporate investment to China key factors behind a worsening income gap.

What Can Governments Do?

GOVERNMENTS WHO SEEK to reduce income inequality face a dearth of viable options: It is much easier to identify what doesn't work than what does. Trade and capital controls are problematic, spending on retraining and education may only have limited impact, and more progressive taxation is often a political nonstarter. For economies like Taiwan's, the best course of action may be to promote a more efficient and higher-quality services sector.

Absent any solid evidence that more trade leads to rising inequality, erecting trade barriers could be counterproductive

and would likely only shrink a country's GDP. Capital controls are more tempting, with some evidence that both inbound and outbound FDI may be linked to rising inequality. But after opening the floodgates in the 1980s, it's unlikely that countries like Taiwan and South Korea would be able to dam up the flows now—and such moves would likely only hobble their firms' international competitiveness. Taiwan's China-specific controls, as already noted, have not been effective. Although China-bound investment is officially capped at 40% of a firm's net worth, companies get around this by establishing subsidiaries abroad. In fact, some economists and politicians—especially on the pro-unification side—argue that fewer controls on China-bound investment, along with direct cross-Strait transport and banking links, would actually encourage more Taiwanese money and talent to stay on the island.

With few experts willing to be seen as opposing globalization, the usual prescriptive mantra for fighting inequality is more education and training. From Thomas Friedman to Joseph Stiglitz to the IMF, the pundits are unanimous in suggesting that governments must help more of their citizens gain the high-end skills they need to survive in today's globalized world. But bluntly put, for many less-skilled workers—particularly older ones—no amount of retraining and continued education is going to bump them into the highly-skilled, high income bracket. Taiwan has high education spending and a strong safety net that includes comprehensive national health care, which accounts in part for the absence of extreme poverty on the island. But such benefits have not reversed the trend toward more inequality.

Progressive taxation is an often-pro-

posed fix from the left, but redistributing funds from the rich for social programs may have only marginal returns. Moreover, in many countries such policies are becoming harder to sell politically.

For Taiwan, perhaps the best fix is to upgrade its services sector—which now accounts for more than 70% of GDP and most of the island's jobs. The bitter irony of Taiwan's restrictions on China-bound investment is that they lock critical sectors of the economy into a state of competitive immaturity. The banking sector is a case in point: The sector remains hopelessly inefficient, with too many banks employing too many people, and rigid government controls over domestic mergers and acquisitions. Taiwan bans its banks from opening branches on the mainland, which has blunted their ability to compete. Macquarie Research Equities wrote in a recent note: "Without access to China (or M&A) in the medium term, the banking sector is structurally moribund." Making service sectors such as banking more competitive could be the key to raising wages for the middle and lower middle class—and that goes for countries at similar developmental stages, like South Korea.

Rumblings of Discontent

CLEARLY THERE ARE few realistic options for reversing inequality without blunting competitiveness. But the cost to governments of doing nothing is also high. In China, the growing divide between haves and have-nots—which often breaks down as a divide between rich coastal areas and the poor hinterland—has spooked Beijing into action. The gap, compounded by widespread corruption among local Communist Party cadres, is seen as one of the driving forces behind the often-quoted "87,000 civil disturbances" that occurred last year. In the Philippines, inequality has helped feed a decades-long Islamist insurgency in the nation's disadvantaged

south—and the political dominance of a powerful landed elite has long blocked much-needed economic reforms. In South Korea, the IMF report quotes an official saying that "if the polarization problem is left unresolved, South Korea could be divided into two, resulting in three Koreas on the peninsula."

In Taiwan, the political implications of rising inequality aren't as obviously apparent—possibly because the problem in Taiwan (with a 0.34 Gini coefficient) is far less acute than in regional peers like the Philippines (0.46) and Malaysia (0.49). But one little-noted aspect of the recent street protests against President Chen Shui-bian is that they were in large part a middle-class revolt. "The wealth gap in Taiwan is very wide, and that was a key point for the protesters," said Marion Wang, a political scientist at National Sun Yat-sen University in Kaohsiung. "Many in the middle class feel that their standard of living has been downgraded. Their incomes have decreased, but prices are rising."

The protests drew most of their recruits from pro-opposition urbanites who have seen their salaries stagnate or drop, while Mr. Chen allegedly lavished diamond rings and other goodies on his relatives with public funds. It's unlikely that so many Taiwanese would have taken to the streets over Mr. Chen's alleged misdeeds were it not for the widespread perception that he has failed to revive a flagging economy in which only the rich are getting ahead. "If you take a look at the protesters, a lot of them are middle-aged women," said Mr. Pan, the cab driver. "They're having trouble balancing the family budget because their husbands don't make enough, and then they see this corruption on TV and it makes them furious."

Unless they can find a way to tame rising inequality, Asian leaders are likely to see more of that fury—either at the ballot box, on the streets, or in a worst case scenario, through more violent forms. ■



Taiwan's Red Shirt Rebel

by Hugo Restall

IN FRONT OF the Taipei train station, a ramshackle cluster of tents and trailers comprise the headquarters of an uprising. Red banners with the characters “revolutionary red shirt army” flutter in the breeze. Next to a portrait of Sun Yat-sen are pasted the words Mao Zedong used to kick off the Cultural Revolution: “It is right to rebel.” So have the red guards come to Taiwan?

Not exactly. But Taiwanese politics, always tumultuous, is becoming even more confusing.

Shih Ming-teh sits in a lawn chair, sipping tea, within an enclosure adjacent to a camping truck. Still handsome at the age of 65, he's wearing his new signature outfit, a red shirt. The color is meant to symbolize the people's anger at the corruption of the two major political camps, he says. In a landscape sharply divided between the greens led by the Democratic Progressive Party and the blues led by the Kuomintang, suddenly there is a new wild card, a kind of color revolution in the middle of a dysfunctional democracy.

This summer, after a steady stream of

corruption allegations emerged against President Chen Shui-bian and his family, the Taiwanese people were fed up. In 2000, they elected Mr. Chen and his DPP largely on the platform of putting an end to “black gold,” the corruption fostered by the KMT which had ruled Taiwan for half a century. Now it turns out the former dissident is no better than those he replaced.

This might have simply signaled another round of interparty bickering of the kind seen for the last six years. Instead Mr. Shih jumped into the fray, lending his moral authority to a nonpartisan movement to ask Mr. Chen to resign. He refused to take large donations, instead asking each supporter to give \$4—he says that within seven working days 1.27 million people donated. At several points, attendees at the red-shirt army's rallies numbered in the hundreds of thousands, with one million claimed on Oct. 10.

Mr. Shih occupies a special place in Taiwanese politics because he paid his dues in the form of prison time and has always gone his own way. He first got in

~ *Mr. Restall is editor of the REVIEW.*

trouble as a high-school student for advocating Taiwanese independence. Having served a 15-year stretch, he became general manager of a banned political magazine, *Formosa*. After demonstrations in Kaohsiung in 1979, known as the Kaohsiung Incident, he and seven other defendants were sentenced to long prison terms by a military court. Defending them was a young lawyer, Chen Shui-bian.

By the time he was pardoned in 1990, Mr. Shih had served 25 years in prison, about half of it in solitary confinement. For several years he staged a hunger strike demanding the release of all political prisoners, so the authorities force-fed him several thousand times.

In the mid-1990s he served as chairman of the DPP. But then he drifted away, alienated by the leading factions' emphasis on Taiwanese independence. In recent years, his views have moved closer to the blues, but he has remained somewhat aloof from politics, refusing to work directly against Mr. Chen out of personal friendship and hopes for improvement. Then the revelations of corruption ignited his anger, like so many other Taiwanese. After he urged Mr. Chen without success to create an independent inquiry, telling him that he couldn't have his right hand investigate his left hand, the break was complete.

Today he is drawing in individual supporters from both camps, even though the KMT gives only tepid backing for the calls on Mr. Chen to resign—which is hardly surprising, given that such an unpopular

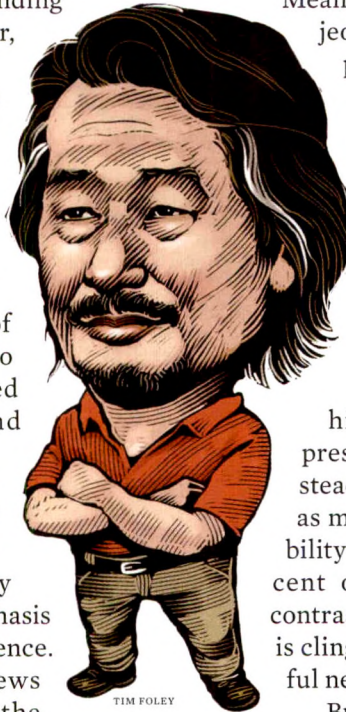
DPP president only boosts their electoral prospects.

The new movement has undoubtedly had a big impact, but today the wind seems to have been taken out of its sails. A third recall effort against Mr. Chen failed, and the president remains determined to hang on, perhaps until his term ends in 2008.

Meanwhile, KMT Chairman Ma Ying-jeou has been accused of impropriety in accounting for a discretionary fund given to him as mayor of Taipei. Mr. Shih says that this has severely damaged the red movement by taking the pressure off Mr. Chen. Mr. Ma responded by donating an equivalent sum of money to charity, a decision that showed a lack of leadership and hurt his chances of running for the presidency, Mr. Shih believes. Instead he should have stepped down as mayor to take political responsibility for the mess, even if he is innocent of wrongdoing. That would contrast with the way President Chen is clinging to power, and set a powerful new precedent.

But already a precedent has been set, that the public prosecutors will go after a sitting president. Mr. Shih believes that the strength of public anger made that possible. Depending on what further evidence comes to light, Mr. Chen could still be forced to resign. The weakness of the current president and outpourings of anger are bolstering Taiwan's system of checks and balances.

That's something that Mr. Shih thinks will have an impact on mainland China as well as Taiwan. He insists that the anti-Chen demonstrations have received widespread media coverage within China. While it doesn't seem that coverage is as extensive as he imagines, some informa-



Legal proceedings to hold President Chen accountable would be watched with great alarm by Beijing.

tion is crossing the Taiwan Strait. Given the even greater extent of the corruption problem on the other side, legal proceedings to hold a president accountable would be watched with great interest by the people, and with alarm by leaders in Beijing. The fact that such large protests weren't incited by the government or any political party, but rather arose spontaneously out of civil society, is unprecedented in a Chinese society.

Moreover, he points to the overwhelmingly peaceful nature of the protests as a sign that Taiwan's democracy can still work, despite all the stresses of this difficult time. There have been some minor scuffles, and the marches weren't always strictly legal, but with some forbearance on all sides the clashes have remained largely rhetorical. Like the protests against Tung Chee Hwa in 2003, the middle class is the mainstay of the movement. This is in marked contrast to South Korea, where there is a tradition of violent clashes.

Mr. Shih's next ambition is to push through new anticorruption legislation

through the Legislative Yuan, followed by other legal reforms. He has already put forward three draft laws.

One big disappointment has been the lack of understanding in Washington. American Taiwan watchers, like their contacts on the island, tend to be divided between the green and blue camps, and so lack a realistic picture of the political situation. That has led American representatives to adopt a threatening and coercive tone, especially on the arms sale issue, that is counterproductive within Taiwan.

Fundamentally, however, Mr. Shih is optimistic that both parties will sort out their problems and Taiwan's political scene will become more healthy. The dpp was always democratic in its internal structure, it's just that as president Chen Shui-bian grabbed an unhealthy share of the power. The party is now in the process of distancing itself from him in order to improve its prospects in this month's local elections. Both the dpp and the kmt contain the seeds of a more constructive two-party system. ■



No Easy Cure: Asia's Health Challenges



Rapid economic development has strained, rather than strengthened, the health systems of many Asian nations. India is witnessing a startling increase in chronic diseases, while countries across the region struggle to secure access to much-needed drugs for their citizens.

India's Chronic Diseases Challenge

by Bruce Neal

THE LAST CENTURY saw huge advances in the health of the Indian population. Life expectancy trebled and rates of childhood and maternal mortality plummeted. But with these successes has come a significant new challenge. Chronic diseases are on the rise and the health system is ill-equipped to deal with them.

Disease is in a state of rapid transition in India. Just how swiftly changes in disease patterns are occurring is highlighted by the findings of a large new study, in which the author was one of the researchers, of 20 developing rural villages in the state of Andhra Pradesh. Results recently

published in the journal *Diabetes Care* showed diabetes is now at levels usually found in developed, Western societies—one in eight of those aged 30 or over were found to have diabetes and an equal number showed signs of prediabetes.

Deaths in these same villages were shown to be due predominantly to conditions previously considered the preserve of developed countries. Cardiovascular diseases, mainly heart attack and stroke, were the leading cause of mortality, responsible for more than one third of all deaths. The next most common cause was deliberate and unintentional injuries, primarily suicides, falls and road traffic crashes. Infectious conditions, such as tuberculosis and diarrhea-related diseases,

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were third and cancers fourth. These findings belie a widely held belief that infectious disease is the dominant factor in mortality in such communities.

The reasons for this transition to "Western-type" diseases in the developing rural sector of India are simple. Reasonable sanitation, a reliable food supply and basic health services have reduced life-threatening malnutrition and fatal infectious diseases in childhood. The great majority of births now progress to adulthood and, injuries aside, few deaths occur among young adults. Most deaths therefore occur from middle age onwards. In developed and developing regions alike, the majority of deaths in middle and older age are due to chronic diseases.

Delaying death from childhood to older age is clearly a major step in the right direction, but comes with the huge burden of chronic diseases. Furthermore, in developing countries like India, conditions such as diabetes, high blood pressure and cholesterol are often untreated, so complications occur years earlier than in Western countries. A much larger proportion of the population is afflicted at an economically-productive, younger age, and the social and fiscal consequences are enormous. It is anticipated that by 2015 cardiovascular disease alone will trim more than 1% from the gross domestic product of India.

The emergence of chronic diseases in developing countries is not unique to India. It is only the very poorest countries in the world that have not already started on this path. Between 1990 and 2020 it is projected that the number of deaths due to cardiovascular disease occurring each year in developing countries will rise from nine million to 19 million. Over the same time span the corresponding increase in developed countries is expected to be from five million to six million.

The high levels of diabetes and cardiovascular diseases reported in this recent

study from Andhra Pradesh are fortunately not representative of the whole of rural India. The villages surveyed were more developed than average and had progressed further down the path toward "Western" diseases than most. These villages do, however, provide an ominous sign of things to come for other parts of India, and the developing world more broadly. The next decade will see many rural areas reach comparable stages of development. Soaring rates of cardiovascular diseases, cancers and injuries will almost inevitably ensue.

Fortunately, India is not without options by which it can address the new challenge presented by chronic diseases. While health infrastructure in many areas is limited, a basic, effective and nationwide primary health-care system (that depends heavily on nonphysician services) is in place. In part, the reason why modern India has to deal with chronic diseases is the success with which this system has addressed major infectious and maternal causes of ill health. Expanding the capacity of this largely nonphysician service may be the best hope for an immediate low-cost assault on chronic diseases.

There are several possible approaches to the problem, but one overriding consideration is clear: India must not try to emulate the chronic disease care mechanisms of high-income countries. The introduction in India of Western-style physician-driven programs could provide a high-cost solution for a wealthy few. But it will do little to contain the epidemic of chronic disease threatening the poor rural majority. Novel low-tech, low-cost and high-value solutions that focus on broadly applicable interventions must be the priority.

For diabetes and cardiovascular disease, the results of decades of research in the West provide clear guidance about the form that such programs might take. Systematic evaluations of the costs and effects

of different intervention strategies have been undertaken by the WHO and other groups. There are now many data indicating the likely cost-effectiveness of different approaches to the problem of cardiovascular disease in India. As for most chronic conditions, these strategies fall into three main groups.

• *Classical public health strategies.* These seek to reduce the causes of disease in the entire population. One example is the legislated restriction of tobacco advertising, which has produced significant reductions in the prevalence of smoking in many countries. Effective implementation of the WHO Framework Convention on Tobacco Control (which went into effect in 168 countries in February 2005) should see global benefits from national tobacco-control strategies progressively increase. Such programs do, however, require the active participation of government. Unfortunately, this is only rarely achieved.

While there are public-health success stories, there are also many failures. Despite clear opportunities, most governments have failed to take obvious steps to control key determinants of disease and injury. For example, legislated and enforced use of motorcycle helmets is uncommon in developing countries. And few developing or developed countries have taken any effective steps to control population consumption of major causes of heart attack and stroke like saturated fat and salt.

• *Control of individual risk factors.* Programs targeting high cholesterol have been at the forefront of heart-attack prevention. The problem is that the proportion of the population for whom cholesterol-lowering treatment is recommended has grown ever larger. Nearly everyone would be better off with a lower cholesterol level, and new research studies have progressively lowered the cutoff at which treatment is recommended. As a consequence, the drug cost required to treat the propor-

tion of the population below even conservative cutoffs is now beyond the reach of even the wealthiest countries.

• *Risk-based approach.* The latest strategy for control of cardiovascular disease to materialize, this approach targets people with elevated levels of multiple risk factors. These people are at much greater risk than individuals with isolated risk-factor abnormalities, and have the most to gain from therapy. The chief advantage of the risk-based approach is that it offers greater efficiency. More heart attacks and strokes are prevented by treating fewer people at lower cost.

The efficiency of health-care interventions is at least as important in developing countries as in developed countries. Some estimates put average per capita health expenditure in developing countries at one fortieth of that in Western countries. Gross national income in the West is also much higher—for example in 2005 GNI per capita for India was only \$720, compared to \$31,914 for countries in the European Monetary Union, according to World Bank statistics. The disparity is further exacerbated by the lesser proportion of gross national income expended on health in developing countries (6%) compared to developed countries (10%).

Over the last few decades, research about the comparative cost-effectiveness of different health care interventions has mushroomed. The WHO CHOICE (Choosing Interventions that are Cost Effective) program, for example, has made a systematic attempt to evaluate the cost-effectiveness of a range of interventions for the control of cardiovascular diseases and other conditions. Furthermore, these estimates of cost-effectiveness have been made separately for many different regions of the world.

In terms of the three main approaches to disease control, cost-effectiveness analyses have underscored the huge potential of public-health strategies that change

It can only be hoped that more philanthropic dollars will go to tackling chronic diseases in poor countries.

population-wide levels of risk. If population-wide changes in dietary fat and salt could be legislated, this would be among the most cost-effective ways of preventing cardiovascular disease. The analyses have also served to highlight the much greater cost-effectiveness of new risk-based strategies, compared to older approaches targeting individual risk factors.

There is a great deal of information the Indian government can use in formulating its response to the growing burden of chronic diseases in the country. Already, the government has at its disposal data that provide considerable insight into the likely extent and principal causes of chronic diseases in the country. Likewise there is a wealth of data about ways that these diseases can be modified. Two important things are, however, still required.

First, there needs to be robust information about the practicalities of disease control in very low-income settings such as rural India. Some of the programs recommended by the WHO CHOICE project have been implemented in developed countries, but experience in developing countries is very limited. While some research findings transfer fairly well across societies, evidence about the practicalities of health service delivery do not. For example, medical societies in India might decide to move from an individual risk-factor approach to the medical management of cardiovascular disease towards a risk-based approach. In this case, it will be essential to have a comprehensive understanding of how to achieve this in India. In many developed countries it is only years after making the decision to switch from one approach to the other that any understanding of how to translate the decision into clinical practice has been achieved.

Pioneering approaches should also be considered. One quarter to one third of all strokes and heart attacks occur in people who have survived a previous such event. Such individuals are easily identified by simple questioning, are at very high risk and have much to gain from preventive treatment. It is quite plausible that non-physician health workers could be used to identify and treat these high-risk people. If effective, this might be one way that much cardiovascular disease could be prevented throughout India. Importantly, the cost of access to care would be much lower than would be possible with a traditional physician-based system.

Second, the Indian government must have a high-level commitment to the effort. Population-wide control of the causes of cardiovascular disease will be the most cost-effective intervention, but will only be achieved through the coordinated action of government. The Indian Council of Medical Research can also do much to aid the generation of sound evidence on which cost-effective health policy can be formulated and implemented. However, local access to resources for the type of operational research required is limited and a pending epidemic of this magnitude requires a major response.

It is important to note that the situation described here for cardiovascular disease, while particularly acute, is by no means unique. A myriad of other chronic conditions are on the rise in India and most face similar challenges. A significant new investment and reorientation of developing world health resources is required and health research should lead this transition.

Philanthropic organizations such as the Bill and Melinda Gates Foundation,

the Rockefeller Foundation and the Wellcome Trust have enabled tremendous advances in the delivery of health care in developing regions. Yet, to date, almost their entire investment has been in infectious, childhood and maternal conditions—the traditional scourges of less affluent countries.

We recently saw the announcement from billionaire Warren Buffet that he would donate much of his personal fortune towards global health initiatives. Mr. Buffet showed tremendous vision in directing his donation through the Gates Foundation with its established and respected track record in the dissemination of philanthropic dollars. It can only be hoped that at least some of this new resource will be used to tackle the massive burden of chronic diseases now afflicting developing countries such as India.

Asia's Problematic Patent Laws

by Cecilia Oh and
Caitlin Wiesen

WHEN TRADE MINISTERS adopted the Declaration on the TRIPS Agreement and Public Health at the 2001 WTO Ministerial Conference in Doha, they hailed it as “proof that the multilateral trading system could respond to global public-health concerns.” The Doha Declaration had confirmed the right of governments to use public-health safeguards available in the TRIPS Agreement which were intended to ensure that intellectual property rules—like drug patenting—did not get in the way of achieving public-health objectives such as access to affordable medicines. However, very few countries have used the mechanisms cited

in the Doha Declaration to increase access to medicines, and recent developments in trade negotiations give rise to concern that the use of these safeguards is being compromised.

A number of reasons may explain the scant use of the Doha Declaration and the public-health safeguards it was intended to provide: First, there has been increased donor funding available for the procurement of antiretroviral drugs (ARVs), which has reduced pressure to find cheaper treatments. Secondly, drug companies have offered price discounts on some ARVs to a number of eligible countries. Thirdly, public-health safeguards affirmed by the Doha Declaration have been underused by developing countries because they are not well understood. These safeguards include practices like compulsory licensing, which allows for the import or local production of generic versions of patented drugs, and parallel importation, which enables the import and re-sale of patented drugs from countries where they are sold at a lower price. Finally, the availability of the cheaper generic versions of ARVs from Indian drug manufacturers has enabled many countries to put more people on ARV treatment.

But this last factor is gradually changing. Indian manufacturers have been able to produce generic versions of ARVs thanks to a provision in the TRIPS agreement that allowed countries to delay patent grants on pharmaceutical and agrichemical products until 2005. But now India has had to put into place a product patent regime, with the effect that generic production of new drugs that will come under patent protection in India will no longer be permitted.

Of great interest in India now is the opening of the patent mailbox—where

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Countries must ensure that trade aspirations don't undermine their ability to provide care to citizens.

thousands of applications for patents on pharmaceutical and agrochemical products were regularly deposited since 1995—and the decision of the Indian patent offices to grant or reject these applications. The patent mailbox is the system by which countries that have chosen to use the grace period to delay granting of pharmaceutical product patents, are required to receive such product patent applications, and to grant or reject them at the expiry of the period. Where a patent is granted on a pharmaceutical product, this may bar the production of that product in India.

The new Indian law, however, includes provisions that permit the continued production of generic drugs, even though a patent application in the mailbox is granted, if generic production predated the grant of the patent in India and the generic producer makes payment of royalties to the patent holder. For new drugs that have yet to come on the market however, this may mean that no generic versions will be produced until the expiry of patent protection—unless generic companies in India decide to make use of TRIPS public-health safeguards to permit the local production of patent-protected drugs before patent expiry.

Second-line drugs

THIS SHOULD BE an impetus for countries to seriously consider the use of the public-health safeguards, such as compulsory licensing and parallel imports. As new medicines are typically patent-protected for 20 years in all but the least developed countries, generic suppliers, including those in India, will not be able to reproduce patented medicines without compulsory licensing. This is already the case of medicines such as second-line HIV treat-

ments. International efforts, such as the World Health Organization's "3x5" campaign, have generated awareness on the need for treatment and have helped to put more people on treatment. But it has also increased the need for second- or third-line ARVs, as patients need to switch to these drugs to continue effective treatment after they develop resistance to first-line drugs.

But the competition from generic drugs that brought about big price drops for first-line ARVs does not exist for the newer second-line medicines. Producers in India have not started producing many of these second-line drugs, for a variety of reasons, including uncertainty over the current patent situation, and the lag time between developing a product and rolling it out. So prices of second-line ARVs can be six to 12 times higher than their first-line counterparts, with problematic implications for already overstretched health budgets.

In light of this, there are signs that alternative strategies are being developed to ensure the future sustainability of ARV treatment in Asia. In India, as patent applications in the mailbox are examined, there have been a series of patent opposition cases which seek to challenge the patent applications. These challenges are made on the basis that the applications do not meet the criteria for patenting as required in the Indian patent law, and the public-health interests do not justify the grant of such patents. The Lawyers Collective in India, working in tandem with the Indian Network of People Living with HIV, has sought to challenge applications for patent protection of key HIV/AIDS medicines on the grounds that they are deemed frivolous or of a nonsubstantive nature. In Thailand, there has also been a series of challenges of

patents granted on pharmaceutical products. In 2002, the Thai courts ruled that because pharmaceutical patents can lead to high prices and limit access to medicines, patients are injured by them and can challenge their legality. More recently, the Thai Network of People Living with HIV has challenged the legality of a patent application by a pharmaceutical company which eventually led to the withdrawal of the patent application for a specific ARV formulation in Thailand. Increasingly, patents are being challenged on legal and ethical grounds, as well as from the standpoint that access to HIV medicines is a fundamental human right.

In Malaysia, the government decided to permit the imports of generic ARVs in 2003. Since these ARVs were patented in Malaysia, the government used a form of compulsory licensing that allowed public hospitals to procure generic ARVs from India. Indonesia in 2004 on the basis of a similar provision in its patent law, also granted a license to enable local generic production of two ARVs that are currently patent-protected in the country. The net effect in Malaysia was a substantial reduction in the prices of a range of HIV/AIDS medicines, in some cases by as much as 80%.

Beyond TRIPS and Doha

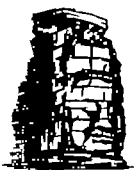
ASIAN COUNTRIES MUST take care that trade aspirations do not undermine the ethical and legal imperatives of providing adequate access to treatment. In the case of the HIV/AIDS pandemic, trade regimes have a direct impact on human lives. While the Asian region has lower rates of HIV prevalence compared to Africa, for example, there is still an imperative to provide treatment to all who need it, not only as a matter of respecting the human right to health, but also to prevent the spread of the disease.

In 2001, having adopted the Doha Dec-

laration on TRIPS and Public Health, trade ministers also pledged to great fanfare that they would make trade liberalization benefit even the poorest countries. Five years on, however, negotiations for the so-called Doha Round have come to a standstill, and talks were suspended in July this year. Because multilateral trade negotiations have proved difficult, a number of countries have been pursuing a strategy of bilateral and regional trade negotiations. Such free trade agreements (FTAs) are sometimes employed to influence other partners in the multilateral negotiations and to establish precedents that can consolidate positions on problematic issues.

In the Asia-Pacific region, a number of countries are now negotiating or entering into negotiations of bilateral trade agreements that may include higher levels of patent protection. The so-called "TRIPS-plus provisions" include extensions of the minimum 20-year term of patent protection, restrictions on the use of compulsory licensing and parallel imports, and requirements for exclusive rights over the use of data from clinical trials that are submitted as part of the drug-approval process. The effect of these types of provisions will be essentially to extend the period of market exclusivity of patented products, which would potentially make them more expensive, given the delaying of competition.

Developing-country FTA signatories usually have defensive negotiating interests on intellectual property. Nonetheless, a number of them have been willing to accept stronger intellectual property rules as a *quid pro quo* for concessions in other areas, such as preferential access to developed countries' markets for agricultural and manufactured products. But there is insufficient evidence that this is an equal bargain. There is, therefore, an urgent need for further research and empirical data before policy makers make decisions such as these that can incur a heavy human cost. ■



Vietnam Must Map Its Own Flight Plan

by David Koh

WHETHER ONE IS sitting at a sidewalk café in a major city of Vietnam, or wandering the countryside—where 70% of the Vietnamese population resides—growth and development are the persistent impressions. The country has taken the much traveled road of allowing foreign direct investment to flow in and drive exports, which has in turn spurred the domestic economy in two long spurts of growth—the first between 1991 and 1997, and the second from 2000 until who knows when. This strategy, coupled with strong government infrastructure spending has produced very good outcomes in the past 20 years of *doi moi*. Vietnam is now witnessing a second wave of foreign investments unseen since 1997. In 2004 and 2005 the growth in new FDI was 41% and 50% respectively, when compared to the previous year. Cumulative FDI (on a pledged basis to the end of 2006) is now almost \$60 billion, whereas about \$35 billion had been realized by the end of 2005.

Vietnam's economic growth rate in the past five years has averaged 7.5%. This was

the best among all member states of the Association of Southeast Asian Nations, but of course second to China in the East Asian region. Annual per capita income is now \$640. Absolute poverty is climbing down while income inequality has inched up. Land prices in the center of Hanoi and Ho Chi Minh City are among the highest in East Asia. Outbound tourism has exceeded inbound tourism, and the demand for consumer goods is immense, with overseas shopping trips frequent for the rich. Shares of GDP by manufacturing and services together have climbed up to exceed 70% and each are both above the share of agriculture, which is expected to eventually drop to 20% by 2020.

Similar But Different

AT THE HEART of Vietnam's successful strategy is economic reform first, administrative reforms second, and political reforms last—as evidenced by the frequent clamping

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down on dissident voices that call for greater political freedoms. Like its counterpart in China, the Vietnamese Communist Party believes that economic performance is the key pillar of its legitimacy, allowing the Party to brush aside concerns about the lack of political reforms. By keeping the Vietnamese Communist Party in charge and pushing liberal democratic changes off the stage, political stability thus achieved has provided a predictable environment for domestic and foreign business. This lopsided strategy has, however, sprung fundamental socioeconomic changes that the socialist ideology must explain and justify. Certainly, the Chinese joke about "signal left but turn right" still applies to both countries to a large extent. Both still suffer from the abscess of a dominant state sector that is funded chiefly by the state budget, and a huge state contribution to the GDP. The state still dictates economic activities and if economic activities endanger the political supremacy of the Party, inevitably the pace of economic growth has to slow down. Both countries also suffer from rent seeking corruption, and a single dominant political party leads each country.

The key ingredient for the success that Vietnam and China have had in drawing in FDI is their cheaper labor costs as well as huge domestic markets that are often perceived as ready for foreign penetration. The power of these comparative advantages, true when we compare Vietnam and China with the older members of Asean (such as Brunei, Indonesia, Malaysia, the Philippines, Singapore and Thailand), somehow become dimmer when we compare Vietnam only with China. These two are after all two competing economies; while they do not produce all the same goods, costs structures of their manufacturing goods are similar, with China having an advantage because of its much bigger market and thus lower costs of production for Chinese producers. For Viet-

nam to succeed in the rising age of China, it has to distinguish itself from China, although past mimicking had elevated Vietnam to present developing dragon status. Vietnam will have to map its own flight plan. The question is: Can it do it?

A Flight Plan for Vietnam

FIRST, VIETNAM'S GOVERNANCE—political and corporate—has to become much more nimble and accountable than China's. Inevitably, larger countries tend to be more chaotic than smaller countries. So Vietnam—as a relatively small nation—has no excuse not to perform well in this area. Simply put: Good governance attracts investment. Like China, Vietnam is stymied by years of socialist bureaucracy. According to government surveys, bureaucrats are severely underpaid compared to costs of living. In particular, the government needs to play especially close attention to ensure the quick disbursement of pledged foreign investments—which run to almost double the amount of realized investments.

Second, Vietnam should make sure that its comparative advantages in a market economy are in specific areas that do not target mass markets in the way Chinese comparative advantage does. The processing of agricultural goods is a good example. Many of the agricultural goods Vietnam produces are inherently different from those produced in China. While a shining performer—and likely to benefit from Vietnam's upcoming WTO entry—agriculture is, however, on the decline. Growth of the agriculture and fisheries sector was only 4% in the last five years, compared to 7% for services, and above 10% for industry and construction.

There are two key manufacturing industries that Vietnam needs to develop to get ahead of China. In the electrical and electronics industry, "Made in China" still continues to pose a problem in the minds of

Despite claims of 90% literacy rates, the quality of education in Vietnam still leaves much to be desired.

some consumers worldwide, many of whom equate it with poor quality. Vietnam should exploit this by striving to produce good quality, mid- to high-end products. Japanese electronics firm Canon seems to be the biggest believer as it has almost doubled its investments in recent years. In November, Intel announced plans to increase its investment in Vietnam to \$1 billion from the \$300 million it pledged in February. The chipmaker will build a plant close to Ho Chi Minh City, which is expected to go into production in 2009. While few expect Vietnam to make any rapid jump up the value chain on its own steam, it seems plausible that many multinational corporations will be willing to offer Vietnam a helping hand, especially if it helps the MNCs diversify some risk away from China.

Hot on the heels of Intel's move, Bill Gates' decided to come to Vietnam and see for himself what opportunities the country holds—this time in the software industry. This is the second high value-added industry in which Vietnam has a comparative advantage. The use of the Latin alphabet in the Vietnamese language puts it ahead of the character-based Chinese language in terms of responding to the needs of the software industry. Already Vietnamese companies are conducting outsourcing and subcontracting for many software companies overseas. While not a regional giant yet, the tendency for Vietnamese, especially youths, to take quickly to new and hot technology will drive the Information Communications Technologies (ICT) market in Vietnam and, over time, greatly increase the ability of Vietnamese firms to supply to the global market.

In the race with China, one point to note is Vietnam is probably not competing

directly with the inner provinces of China, but those that are on the coast and are attracting huge amounts of FDI and domestic investments for export industries. The production networks in southern and coastal China are not necessarily relocatable into Vietnam, but perhaps planners in Hanoi need to see how such networks can be established across its own provinces. In order to do so, an immense boost in education and training for the market in close consultation with investors is essential for success. It is oft-repeated that Vietnam has a literacy rate of over 90%, but the quality of education—even basic education—leaves a lot to be desired.

Chop-chop!

IT SHOULD ALSO be said that Vietnam's leaders—advised by economic, foreign policy and defense officials—are not reacting quickly and positively to Chinese moves to integrate Vietnam and the rest of Southeast Asia with the southwestern provinces of China. While there is agreement at the highest political level, movement on the Vietnamese side to realize the “One Circle, Two Corridors” initiative is slow. Here is an enormous opportunity to spur growth in the northern Vietnamese provinces, but the government machinery is not getting its act together.

Vietnam should also move quickly to restructure and reorganize the state sector of its economy. In most countries, the private sector is usually more efficient and quicker to respond to market needs than state enterprises. Achieving this faster than China should put Vietnam in an advantageous position. Again, however, I am also pessimistic on this because the Chinese have shown they are more willing to

chop and change quickly and to rally around goals defined by a set of strong leaders than are the Vietnamese. Years after a declaration to reform its state enterprises, there remains little hard evidence of such reform. The bright spark on the horizon is that becoming privatized and eventually becoming a public company is now a very attractive prospect for many major state enterprises, as a number of listings late last year and in 2006 have shown. Hopefully such benefits could persuade directors of state companies to work towards listing and subject themselves more to market discipline than bureaucratic inertia. In this sense the stock exchange, too, clearly will have to strengthen its watchdog role.

But perhaps the most important element of Vietnam's flight plan is the need to reignite enthusiasm for and allegiance to strong leadership. A disunited leadership in Vietnam appears to be the root cause behind the slow pace in many areas of reform—state enterprise; ideological; and administrative reform, including reform of the system for government appointments and promotions. The last time any semblance of a policy aimed at quickly promoting talent was introduced—namely the Cadre Rotation System (in place during the period 2001-06)—it was severely criticized by the Ninth Central Committee for being loaded with factional overtones.

The greatest challenge to the system is the fairly even distribution of power, and the fragmentation of authority. Almost every area of public policy has several masters to answer to, and appointments of ministers often have to pass through more than 10 authorities before a nod can be given. Previous prime ministers, as recent as



In November 2006 chipmaker Intel announced plans to increase its investment in Vietnam to \$1 billion.

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Phan Van Khai (1998-2006) have lamented that they do not even have the freedom to hire and fire ministers as they wish and yet must be responsible for the government's performance. Shifting factionalism, based on ever-changing interests rather than ideology or firm beliefs and loyalties, divides the Vietnamese leadership. Peaceful, socialist Vietnam has not produced another charismatic leader able to pull all factions behind him as Ho Chi Minh did so well.

To be like Ho Chi Minh is to have a vision; now the construction of this vision is so mired in the capitalist versus socialist controversy, and the security versus growth debates, that vision is simply impaired. What follows is a high tendency to compromise and strike consensus. Therefore, the Communist Party holds much power over society, but within the Party this power is fragmented. Corruption has gradually become the single most effective method of increasing power by any political faction, but the more this method is used, the less any leader would have authority over the others alongside and everybody else below. Thus the fight against bureaucratism and corruption in Vietnam is one that is decades old rather than one born after *doi moi* in 1986.

A Positive Prognosis

YET THE PROGNOSIS for Vietnam seems to weigh in more on the good than the undesirable, with some problems thrown in between. So long as the economic performance is good and employment available, society is likely to be stable and therefore performance legitimacy will kick in. On the margins, a small number of activists make a lot

of noise but are getting nowhere near to dislodging the Communist Party. They will stay on the margins so long as the media is still under the tight leash, as it is now. In industrial relations the state will continue its facilitating stance toward business by effectively outlawing labor strikes. Per capita income will continue to grow, pulling consumer demand along. GDP will grow at about 8% per annum which should see the economy double in the next 10 years, when compared to present levels.

Of course, there is always the possibility of Vietnam being beset by hubris. In this scenario Vietnam does little to try to exert itself but instead sits proudly on its current achievements and becomes a hard-to-please player in the globalized world. This hubristic stance occurred once before, in the mid-1990s, just prior to the Asian Financial Crisis, which led the Vietnamese to rethink their FDI and domestic macroeconomic policies. Could a second bout of smugness emerge? This is possible if the current wave of investment surges greatly and Vietnam succeeds beyond its own dreams in the next three to four years. "The world needs Vietnam" would be the slogan of this conceit. I am not quite sure that Vietnamese bureaucrats (rather than leaders) fully feel the intensity of the long-term competition from the country's north, as the opportunities for reform and successes in the last 20 years have led them to feel that the most they need to do is to continue with current economic policies and the investors will come. The reality, of course, is quite different.

Another scenario is one where Vietnam leaps to a higher point in the value chain compared to where it is now. There is some evidence that a little of this is happening but in only baby steps. Yet the potential is considerable. As mentioned, Vietnamese youths take to computers very quickly and there is much potential in the ability of the ICT industry to excel, espe-

cially the software sector. The government does have a vision to try to lift the country into the top 15 software-producing countries of the world by 2015. Perhaps this vision does not necessarily have to be confined to ICT. Other high value-added industries that Vietnam might start, develop, and achieve encouraging results in include: high-end services in tourism; evolving into a financial hub for southwestern China and Indochina; and excelling as an export and services hub for southwestern China and Indochina, posing a very strong challenge to Thailand and to Singapore. In addition, Vietnam is probably the only country in Southeast Asia that knows Eastern Europe more than the other countries, given its historic ties to the socialist economies of the region. This could allow Vietnam to forge partnerships with other Southeast Asian countries such as Singapore that wish to have stronger economic linkages with Eastern Europe.

A particularly worrying issue is how Vietnam will stand up to competition from China. For sure, it will be overwhelmed by China in many areas, but will manage to defend itself in areas where it has a non-efficiency-based advantage. Vietnam is currently experiencing a boom because its policies have improved compared to three years ago and many foreign investors seek to diversify away from China. Inevitably, some hubris will return, but some lessons have been learned and it is unlikely the country's leaders will become as complacent as they have been in the past when faced with economic success. Within Vietnam the awareness that the country cannot stand still but has to adapt and change will heighten; however, the ideological and political problems will continue to be insurmountable in so far as they are firmly entrenched in a fear of the unknown. This may drive Vietnam to keep a watchful eye on other countries' (read China's) flight plans for some time to come. ■



China Should Also Invest More

by Hong Liang

MUCH OF THE concern about global imbalances have centered on the unprecedented high United States current account deficit and the rising surpluses elsewhere in the world. Should this imbalance be viewed as a savings glut, or is the true problem is the world is investing too little? Raghuram Rajan, the IMF's chief economist, say it's the latter, and argues that more investment is needed in the surplus countries. But he cautions that "China is an exception in needing less, not more, investment."

Mr. Rajan views are probably based on one of the most popular and widely held views against investment in China. The argument often goes as follows: fixed-asset investment growth is excessive, while the investment-to-GDP ratio in China is already more than 45%—above the levels reached by Asian economies before the 1997 crisis; this investment boom is financed by misallocated bank credits and generates little returns; and therefore, there is an overinvestment time bomb in the Chinese economy, which will soon result in a sharp correction in investment

and GDP growth, rising NPLs at the banks, and deflation.

Given the prevalent suspicions of macro data from China, it is indeed surprising to see that many people have based their entire assessment of China's economy on one data point—the reported investment-to-GDP ratio. Suspicions arise when one tries to derive the implied growth rate or the national savings rate using the reported investment-to-GDP ratio. For example, if investment has grown at 20%, and if the ratio of investment to GDP is around 45%, real GDP growth from investment alone would be 9 percentage points, even without any growth in consumption and net exports. Alternatively, the reported current account surplus is about 8% of GDP. Adding a 45% investment-to-GDP ratio, this would imply China's national saving rate is above 50%! However, most studies find the national saving rate for China is at most in the low 40s. Arguably, international trade data are the most reliable macro data points for China. Therefore, this casts serious doubts on

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the assertion that China's domestic investment-to-GDP ratio is above 40%.

The headline investment growth is likely being overstated, and more importantly, the GDP level and growth being understated because of significant underestimation of consumption. The latest upward revision of the GDP level in 2004 by almost 17% exemplifies the point starkly. Most of the revision came from upward adjustments of the service sector, resulting in an upward revision to the share of consumption in GDP.

The emergence of housing demand since the end of the 1990s is likely a main contributing factor to the misperception of overheated investment vs. inadequate consumption. Is buying a house an investment or a consumption outlay? Private housing purchases are classified as investment spending in China, following conventional international practice. However, housing spending started from a nil base in 1998-1999 but has since been growing much faster than GDP. As a result of such a rapid structural change in household outlays, the debate seems to be barking up the wrong tree. How can consumer demand be weak in China when housing and auto sales have skyrocketed in the last few years?

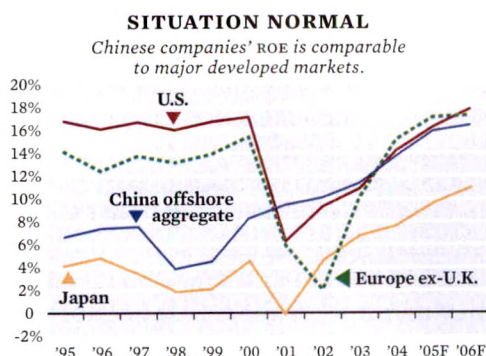
Another often-forgotten dimension in China's over-investment debate is that the level of investment-to-GDP ratio is intricately linked to an economy's development stage. It tends to rise for countries during their period of fast growth, often associated with the fast industrialization process, as their total capital stock to output and labor ratios trend up from relatively low levels. In addition, the real investment-to-GDP ratio may need to be around 40% in order to support China's 9% plus annual growth. The intuition is simple: with fast growth, more investment is needed not only to produce more output but also to replace depreciated capital stock.

As China grows and catches up with the richer nations, further capital deepening

will be a crucial part of the process of becoming rich. Despite 27 years of fast growth and a formidable economy in aggregate size, the fact remains that China is still a low-income developing country on a per capita basis, and its capital-to-labor ratio is still a fraction of that in the U.S. and Japan. Goldman Sach's BRICs research projects that, by 2035, the size of the Chinese economy may surpass the U.S. to become the largest economy in the world and be 11 times what it was in 2004 in nominal dollar terms. Assuming the capital-stock-to-output ratio stays constant until then, China would need to expand its total capital stock by 11 times in dollar terms. Moreover, if the capital-stock-to-GDP ratio needs to rise further in the medium term, the investment-to-GDP ratio would need to be even higher.

Nevertheless, there could still be serious bumps on the road if investment returns fall below the cost of capital. Data issues aside, neither the speed of investment nor its ratio to GDP can tell investors much about the sustainability of China's investment strength. It is the efficiency of investment that ultimately holds the key to the sustainability question, although little efforts have been made to check how corporate profits have actually performed. If one examines financial data reported by Chinese companies listed overseas (about 500 plus companies), and those by the National Bureau of Statistics (about 200,000 listed and unlisted companies), the actual "stylized" facts on corporate profitability in China in recent years paint a very different picture than the popular perception that China has invested too much inefficiently:

First, corporate profit growth has consistently surprised on the upside in the last five years. Despite persistent warnings or predictions of a collapse in corporate earnings by many analysts, after-tax profit growth each year has stayed in the 20%-40% range since 2002, exceeding market consensus by a significant margin.



Second, return on capital has been solid, on an uptrend, and substantially exceeded the official lending rates. A divergent path between the actual rate of return on capital and the growth rate of capital stock tends to be a good indicator that there may be some overexuberance by investors. But using the NBS data, one finds the after tax rate of return on invested capital has risen steadily since the late 1990s, exceeding historical high levels, and showing no signs of any divergence from the speed of real capital accumulation. Interestingly, based on the same methodology and database, a significant divergence did show up during the 1993-95 investment boom-bust episode, when the rate of return was deteriorating in tandem with accelerating capital accumulation. If one has doubts about the quality of the NBS data, let us take a look at the performance of the overseas-listed Chinese companies, whose financial reports are audited according to international accounting standards. Here again, the popular perception that Chinese companies generally deliver mediocre shareholders' returns finds little support. Chinese corporates' return on equity (ROE) has actually been solid and rising steadily in the last few years, and now stands at around 15%, comparable to other developed markets (see chart).

Thirdly, corporate China is modestly levered and investment is funded mostly through retained earnings. Bank financ-

ing only provides about 20%-25% of the funding source for China's investment, and its share has been declining, while the bulk of the investment spending has actually been funded through retained earnings. As a result, Chinese companies are able to gradually de-leverage and reduce their dependency on debt to finance their capital needs despite their fast expansion. The high credit-to-GDP ratio (114% as of June 2006) in China does not reflect high corporate leverage, but rather the limited development of the bond market. For example, even though the credit-to-GDP ratio in the U.S. is only 44%, the size of its corporate-bond market is more than 100% of GDP, compared with about 4% in China.

Fourth, if profit growth persistently outpaces the overall GDP growth, the share of national income that accrues to capital must be rising. China's flows of funds data indeed confirm that the share of capital income has been rising steadily since the late 1990s, while the share of labor income has been falling. This is contrast to the early 1990s, when corporates had dismal earnings growth despite the macro boom. This finding has two other significant implications. First, wage costs have been managed much better during this cycle compared with the early 1990s, likely reflecting rising labor-market flexibility. Second, the implied income distribution, however, may also explain why mass consumption has been more muted than high-end consumer demand, for property and auto.

Fifth, corporate China would have earned higher returns if commodity prices were lower. Unlike Russia or Australia, China is a net (and growing) importer of oil and most commodities. Therefore, high and rising commodity prices present a negative terms-of-trade shock to China, and should be damaging to its aggregate corporate profitability.

Lastly, profit margin is held up steady at improved levels, and the PPI-CPI infla-

tion gap does not signal profit squeeze. If we use the total-net-profit-to-sales ratio as a proxy for average profit margin, the corporate profit margin of "China Inc." began to perk up in 2003, and has remained at cyclical high levels in the last few years despite the significant cost increase in raw materials. Moreover, the empirical correlation between corporate profitability vs. the PPI-CPI inflation gap is strongly positive, and exactly the opposite of what has often been suggested. Furthermore, this positive relationship also applies to downstream industries. If there is any empirical causality (that is, which data series tends to lead the other), the data seems to suggest it is the rise in PPI inflation that tends to indicate better profit growth.

But, if China's real economy is so impressive, either in terms of its overall real growth or the rate of return on investment, why has the performance of its financial sector been so disappointing? The answer to this disconnect goes to the fact that the state-owned financial sector has mostly served the inefficient SOEs, but provided little service, if at all, to the most vibrant part of the economy—private enterprises. Therefore, the performance of the financial sector does not reflect the performance of the overall real economy, but rather those of the inefficient and declining part of the economy. Policy prescriptions for China can differ fundamentally depending on the diagnosis for the economy. If the real problem of the underlying economy is indeed over-investment with a falling rate of returns, then policy adjustments should aim at restraining investment growth while promoting consumption and export growth. However, if the real imbalance in the economy is insufficient domestic demand amid rising trade surpluses and robust corporate returns, the right policy choice should involve a real appreciation of the currency to smooth the demand rotation away from exports, and implementing other domestic-

demand-friendly policies, including those supporting domestic investment.

What can China invest in? China still has a big deficit in urbanization-related investment, as its ratio of urban residents to total population remains exceptionally low by international standard. Industrialization without urbanization is a unique Chinese phenomenon, owing to decades of government policies that segregated urban and rural labor markets. The release of the "pent-up" demand for urbanization in China will not only sustain investment demand from China for longer, but will also be one of the most important events affecting the global economy in the next few decades, not least through its impact on industrial and soft commodities. This process will likely involve substantial investment in infrastructure and housing-related (electricity, water, and waste treatment systems, as well as residential property) projects. Such investment is being undertaken less to increase the supply capacity of China as a manufacturing powerhouse, but more to facilitate urbanization and further increases in consumption by the Chinese as they grow richer and more affluent.

Therefore, a successful rebalancing of the Chinese economy, and to a large extent the global economy, needs to involve a smooth transition of more investment domestically by the Chinese and less into the US (or any other OECD countries') Treasuries. On this note, Mr. Rajan at the IMF is wrong—China, too, needs more, not less, investment, perhaps in order to eventually consume more. The key challenges facing China in are twofold: First, will China allow more yuan appreciation to curtail domestic inflationary pressures in the process of investing more domestically and help international demand adjust smoothly? And second, can China fix its financial system quickly and sufficiently so that more investment is allocated to the right sectors and companies? ■



REVIEWS



**BEYOND LIBERAL DEMOCRACY:
POLITICAL THINKING FOR
AN EAST ASIAN CONTEXT**

by Daniel A. Bell

Princeton University Press,

408 pages, \$24.95

Reviewed by DAVID PLOTT

POOOR DANIEL BELL. The Canadian-born professor of political philosophy and ethics at Tsinghua University in Beijing is often condemned to suffer slings and arrows of outrage when it comes to his views on Western political values and their relevance to Asia. He is frequently, and wrongly, accused of being an apologist for Asian leaders who rationalize their opposition to Western liberal notions of human rights, democracy and capitalism by appealing to Asian traditions and ways of thinking. At the same time, some in Asia see him as a Trojan horse for those very same Western values.

If Mr. Bell sometimes seems to provoke both sides in the debate over liberal democracy, it is because, one suspects, he wouldn't have it any other way. He deliberately stakes out a middle ground full of minefields, an approach that ensures most readers—Western and Asian—will be guided across explosive arguments that unsettle or alter their way of thinking.

Beyond Liberal Democracy, though, seems aimed mostly at traditional advocates of Western liberal political theory who claim to represent universal values. Mr. Bell is particularly sharp in his criticism of those who, through their ignorance of Asian history, culture and political philosophy, refuse to entertain the idea that

there are morally defensible alternatives to Western liberal politics.

"I want to allow for the possibility that there are different legitimate ways of prioritizing values and organizing societies," he writes. "It's not to say that anything goes, but there can be justifiable moral diversity; we needn't rank all values according to a common scale."

Mr. Bell organizes his arguments around a detailed, but somewhat idiosyncratic, discussion of the three foundations of liberal political theory—human rights, democracy and capitalism. In each case, he poses essentially the same questions: Are there elements of Asian history, culture and philosophy that provide significant alternatives to understanding these three concepts; and how have these concepts been received and modified by their encounter with East Asian cultures?

A central theme that runs throughout the book is the idea that Western liberal thinking emphasizes civil and political rights, while Asians place more emphasis on economic, social, and cultural rights. The inevitable trade-offs in the pursuit and preservation of these rights are what defines the contested ground in the debate over liberal democracy. This is an area Mr. Bell explored in an earlier work, *East Meets West: Human Rights and Democracy in East Asia* (Princeton University Press, 2000), but his latest book broadens the canvas considerably.

Although Mr. Bell draws on a dazzling

Mr. Plott, a former editor of the REVIEW, is deputy director of the Journalism and Media Studies Centre at the University of Hong Kong and managing editor of *Global Asia*.

range of contemporary and historical material to demonstrate the Asian context in which human rights, democracy and capitalism are differently understood here than they are in the West, he relies heavily on Confucian philosophy to make many of his arguments. This is especially the case in his use of Mencius, a 4th century disciple of Confucius, to compare Western and Asian definitions of just and unjust wars. In doing so, Mr. Bell points to some very compelling arguments made by contemporary Chinese academics about the U.S.-led war in Iraq.

This isn't to say that he approaches Confucian philosophy uncritically. He freely admits, for example, to rejecting the relevance of Confucian arguments in favor of patriarchy, which have been used by some Asian leaders to justify their policies. Nevertheless, it will come as a disappointment to some readers that Mr. Bell doesn't explore as thoroughly other deeply rooted religious or philosophical traditions in Asia, including Buddhism, Daoism and even Islam, in making his case for an Asian context for liberal democracy.

Part of the reason for his focus on Confucianism, though, is its clear importance as a political philosophy in a number of East Asian countries, including China, Korea, Japan, Singapore and Vietnam, for so many years. Also, it continues to influence what he calls "habits of the heart" in much of the region. But there is another reason Mr. Bell emphasizes Confucius: Much of this book draws on his personal experiences in Asia since 1991, and he has spent most of that time living and teaching in Singapore, Hong Kong, and China, three cultures that have been deeply influenced by Confucian thinking.

Indeed, one of the characteristics of this book is how strongly it is marked by Mr. Bell's own personal experiences. There is an edgy, almost quirky quality to the way he moves from one topic to another, or to the amount of space he devotes to some

subjects rather than others. This is true in the body of the text, as well as in the copious footnotes that sometimes take up as much of a page as the main text. Why, for example, does he devote 41 pages of the 91-page section on capitalism in Asia to a discussion of foreign maids in Singapore and Hong Kong?

Some readers will no doubt see this as a flaw in the book. It isn't a systematic, academic treatment of the subject. Despite its lofty veneer, *Beyond Liberal Democracy* is an intensely personal engagement with the author's experiences of Western liberal political ideas in an Asian context. In less capable hands, an exercise like this would have resulted in a self-indulgent book. Mr. Bell, though, is a provocative thinker. He is also refreshingly candid. One might not always agree with him, but the result is an important contribution to the debate about liberal democracy in Asia.

At a time when India, the world's largest democracy, has shouldered its way alongside China in the continuing story of Asia's breakneck economic development, the debate over the relationship between liberal democracy and economic development is far from over.

CHINESE POLITICS IN THE HU JINTAO ERA: NEW LEADERS, NEW CHALLENGES

by Willy Wo-Lap Lam

M. E. Sharpe, 376 pages, \$29.95

Reviewed by DANA WHITE

IN THE RUN-UP to Britain's handover of Hong Kong to China in 1997, Prince Charles described China's leaders in his private diary—later splashed across London's tabloids—as “appalling old waxworks.” And let's face it, he wasn't that far off. Ever since Mao emerged victorious over the Kuomintang

in 1949, China has trotted out a parade of geriatric leaders who we were never quite sure were dead or alive. But in November 2002, when the fourth generation of Chinese leaders emerged to usher in the People's Sixteenth Party Congress, a robust, middle-age man emerged as the party's heir apparent: Hu Jintao. Few people outside of China had ever heard of him, and the engineer turned party chief remains an enigma to party faithfuls and China watchers the world over.

In his new book, *Chinese Politics in the Hu Jintao Era: New Leaders, New Challenges*, Willy Lam provides one of the most comprehensive looks at the Chinese president whose meteoric rise took party leaders and the world by surprise. Mr. Lam provides a detailed personal and professional outline of Mr. Hu's unlikely rise through the party ranks, from college professor to president of the People's Republic of China. Like the trajectory of most world leaders, adversity and triumph figured prominently in Mr. Hu's success. Mr. Lam provides a detailed analysis of why President Hu represents the latest step in China's ever-evolving Communist ideology.

When Mr. Hu was named as then President Jiang Zemin's successor, the world wondered if the ascension of this 50-something hydraulic engineer would mark an end to China's succession of geriatric leaders. After all, Mr. Hu has traveled in the West, possesses a pleasant disposition, and is a proponent of "creative thinking." President Hu has worked hard to fashion an

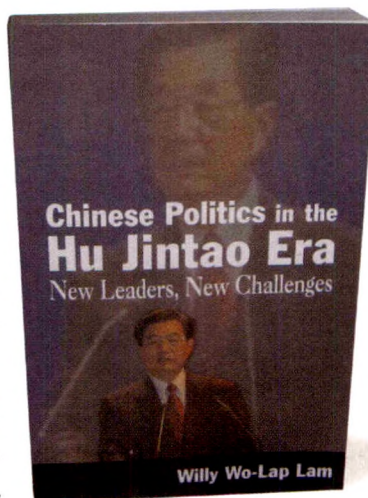
image that is very different from his predecessors, especially former President Jiang. While Mr. Hu hails from Taizhou, a village in Jiangsu Province not far from Mr. Jiang's hometown of Yangzhou, Mr. Hu has successfully geographically disassociated himself with the Shanghai faction, led by former President Jiang and former Premier Zhu Rongji. Under the political radar, Mr. Hu has crafted his image as a "man of the people"—an outsider to the glitz and glamour of Beijing and Shanghai. By skillfully promoting his years working in the poor northwestern province of Gansu, Mr. Hu has perhaps emerged as China's first

bona fide politician—simultaneously pacifying the party machine and stirring the imaginations of the people.

Mr. Lam begins by providing a detailed biographical sketch of the unlikely Chinese leader, from his beginnings (which were not as humble as he'd have you believe), to how he won the heart of Liu Yongqing, his classmate and future wife. Mr. Hu was protégé of ousted party

chief Hu Yaobang (no relation) and Song Ping, Gansu party secretary and ardent opponent of market reform, and both men made an indelible impression on him. But it is Mr. Lam's analysis of President Hu's complex political patronage, his artful deference to party elders, and his management of an often disharmonious relationship with former President Jiang that gives the reader insight into this consummate politician.

Similar to the rise of leaders all over the world, fate, timing and maneuvering played a large part in Mr. Hu's rise to prominence. When his mentor Mr. Hu



≈ Ms. White is an editorial writer for *The Wall Street Journal Asia* in Hong Kong.

Mr. Hu emerges as a bona fide politician who pacifies the party machine while stirring the imaginations of the people.

Yaobang was ousted as party leader in Gui-zhou after mishandling a student protest in 1987, Mr. Hu Jintao remained relative unscathed by his fall from grace. However, his refusal to criticize his long-time mentor proved damaging. After laboring for years in the hinterlands of China, in hopes of getting a plum posting in Guangdong or Jiangsu provinces, Mr. Hu was made party secretary of Tibet. Ironically enough, it would be another uprising that would solidify Mr. Hu's political future.

In 1989, Beijing had agreed to allow to the Panchen Lama—second only to the Dalai Lama—to return to Tibet. The Panchen Lama was far more agreeable to Beijing and his return was meant to defuse mounting anti-Chinese sentiments in Tibet. Unfortunately for Beijing, the Panchen Lama had a heart attack and died while preaching to an audience. His death culminated in a bloody uprising in March of that year, just months before the Tiananmen Square massacre. Mr. Hu, a new and young party secretary, persuaded Beijing to declare marshal law, but curiously in the days following the decision, he took no action against the rioters. According to Mr. Lam's account, the police chief asked Mr. Hu several times for permission to crack down on the protest, but Mr. Hu simply told him to stay vigilant. When the police chief wanted clearance to use force to deal with the rioters, Mr. Hu made himself unavailable for such a request. Without guidance, the police chief decided to use force against rioters and the uprising was put down. While Mr. Hu took credit for the successful suppression of the riots, he ensured his own political survival by creating a convenient scapegoat in case of failure. His approach became Beijing's archetype for handling future uprisings—plausible deniability. Mr. Hu's political

savvy surpassed that of his mentors or his contemporaries. His keen skills gained him the respect of the party's top leaders, particularly former President Deng Xiaoping, who ultimately secured his succession as general secretary of the Chinese Communist Party and the president of the People's Republic of China.

Keen observers reading *Chinese Politics in Hu Jintao Era* will be surprised how China's Communist Party politics mirror the idiosyncrasies of politics in the West. President Hu seems to be the appropriate man to lead China into the 21st century: He is highly intelligent, affable, adaptable, and like most politicians, knows the best way to deal with "change" is by being firmly in control of it.

JAPAN REMODELED:

**HOW GOVERNMENT AND INDUSTRY ARE
REFORMING JAPANESE CAPITALISM**

by Steven K. Vogel
Cornell University Press,
272 pages, \$37.50

Reviewed by COLUM MURPHY

HAS JAPAN REALLY reformed, or have some cosmetic touch-ups here and there duped us into believe that lasting, structural reform is underway? Steven Vogel believes that reform has taken place, describing Japan's post-bubble self-doubt as a "collective reform frenzy," to which he says the Japanese government and industry have responded. Mr. Vogel, an associate professor of political science at the University of California,

Mr. Murphy is deputy editor of the REVIEW.

Berkeley, gives a comprehensive list of the actions taken to shake up the economy:

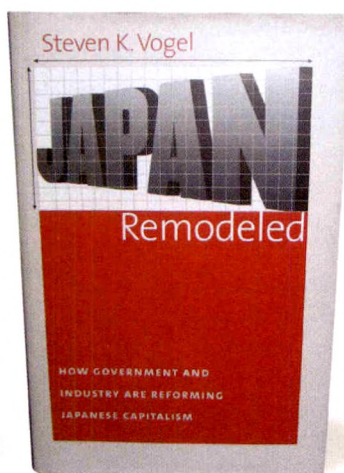
The government lowered interest rates, increased and decreased public spending, lowered and raised taxes, coddled and cracked down on ailing banks, liberalized financial flows, eased labor standards, revised corporate law, lifted the ban on holding companies, privatized special public corporations, and revised the pension system. Just for good measure the government also reorganized itself. Meanwhile Japanese companies sold off subsidiaries, spun off divisions, switched supply sources, moved production overseas, renegotiated loan repayment schedules, introduced merit-based wage systems, reorganized their boards of directors, and experimented with stock options and share buybacks.

Quite an impressive list of achievements, and surely enough to cause us to question the less-than-stellar evaluations of Japan's reform efforts by some commentators. There are several possible reasons for the disparity in views. For one, Mr. Vogel's scope extends beyond financial reform and embraces areas such as labor relations and the competitiveness of Japanese industry. He also combines analysis at the micro level, looking at specific companies such as Toyota, Nissan and the retailer Seiyu, for example, and shows that the degree to which reform is embraced varies from company to company.

But perhaps the most important consideration is the measuring stick against which Mr. Vogel is gauging reform and change. Paradoxically, even though he

goes to painstaking lengths to make comparisons between Japan and the United States and Germany, a key point he makes early in the book is that Japan cannot be compared to the U.S. and the American definition of reform:

For Japan to shift toward the U.S. model, it would not simply have to dismantle existing institutions but also create new ones, and a full conversion would involve changes at all levels of the system: laws, practices and norms. So long as Japan does not make a full conversion, therefore, the legacy of earlier institutions powerfully influences the trajectory of change.



At this point Mr. Vogel will probably lose a lot of readers unwilling to buy into his view of Japanese exceptionalism. For those who hear him out, however, Mr. Vogel presents a very strong case, developing an intricate model that explains how Japan Inc. has changed. Drawing from three schools of economics—new institutional economics, the varieties of capitalism and economic sociology—Mr. Vogel presents his “three circles of rationality” as a basis for examining attitudes and motivations for reform.

The first circle represents a simple cost-benefit analysis. The second circle incorporates elements of institutional costs and benefits, while the third circle looks at social and reputational costs and benefits. Using a real-life example, Mr. Vogel clarifies his somewhat academic treatise as follows:

The first circle represents a simple cost-benefit analysis. The second circle incorporates elements of institutional costs and benefits, while the third circle looks at social and reputational costs and benefits. Using a real-life example, Mr. Vogel clarifies his somewhat academic treatise as follows:

In the first circle, for example, a manager would simply calculate the estimated costs of financing with the firm's main bank

Japanese companies are re-evaluating links to suppliers, banks and workers—keeping ties with some but not others.

versus the costs with a U.S. investment bank. If the competitor were less costly, he would abandon the main bank. In the second circle, however, he would consider the implications for the firm's comparative institutional advantage: He would weigh the cost savings against the potential damage to the long-term cooperative relationship with the main bank. In the third circle, he would broaden the calculus further to include possible costs beyond the main bank relationship, such as damage to the firm's reputation or strains with workers, other business partners, intermediary associations, or the government.

While Mr. Vogel goes to much greater lengths to flesh out his theory, the bottom line is that Japanese institutions and corporations must juggle these three elements, and not necessarily in the same way their Western counterparts might. Labor relations provides a good example, with a telling quote from an executive at electronics giant NEC:

We could not lay off workers in Japan. This is not due to the law, but to the social responsibility. We have 150,000 workers, and most of them have families. We have to think about them. If we laid them off, the local government would get after us, and the media too.

Having established the forces at work that influence the speed and willingness to change, Mr. Vogel then goes on to elaborate an important point: The balance between these forces is changing in Japan. Hence the concept of "remodeling" in the book's title.

There are, he argues, three main ways in which the new Japan is different from

the old one. Yes, partnerships remain important, but companies are becoming more discriminating in choosing who they will partner with. Not all partners are treated equally. Japanese companies are re-evaluating their links to suppliers, main banks and workers, maintaining tight relationships with some while casting others aside.

In addition, the so-called Japanese model—which was never uniform across the economy to begin with—has become more fragmented. Increasingly, companies are willing to find the equilibrium of the three circles that works for them, and that might be different for firms even within the same industry. Whereas in the past industry norms might have determined how an automaker treated suppliers, now an individual carmaker such as Toyota might have a different relationship with its suppliers than rival Nissan. Finally, Mr. Vogel argues that the remodeled Japan is more open to the outside than ever before, with more foreign managers such as Shinsei Bank CEO Thierry Porté or Sony's Sir Howard Stringer.

Leaving aside whether we agree or disagree with Mr. Vogel's framework for understanding change in Japan, one area that disappoints is the predictive value of his model. While he does have a section devoted to "future prospects" for the remodeled Japan, it fills only four meager pages, suggesting only that change will be "continuous" rather than "discontinuous."

In addition, not enough attention is paid to political leadership. Clearly, former Prime Minister Junichiro Koizumi did much during his term in office to promote reform. Yet Mr. Vogel does not consider the prospects for reform in a post-Koizumi era. This is important, as the recently appoint-

ed Shinzo Abe faces a more change-resistant environment, especially in relation to the labor market. The voices of discontent within Japanese society are becoming more vocal as they point out growing income gaps between rich and poor.

In terms of style, Mr. Vogel is clearly at his best when detailing the trials and tribulations of a host of Japanese companies: Toyota and Nissan; Sony and NEC; Seiyu and Mitsukoshi; Shinsei and Mizuho. It's as if hidden in this academic tome there is a journalistic blockbuster just waiting to get out. But whether the arguments are sufficient to convince the rest of the world that the nature and pace of change in Japan is appropriate is another matter.

**ONE WORLD OF WELFARE:
JAPAN IN COMPARATIVE PERSPECTIVE**

by Gregory J. Kasza

Cornell University Press, 189 pages, \$35

**RACE FOR THE EXITS:
THE UNRAVELING OF JAPAN'S
SYSTEM OF SOCIAL PROTECTION**

by Leonard J. Schoppa

*Cornell University Press,
247 pages, £22.95*

Reviewed by DEBORAH J. MILLY

JAPAN IS NOT alone in confronting a falling fertility rate and an ageing population, but the pace of this shift is particularly rapid and the country does not seem able to put a brake on it. Japan's National Institute of Population and Social Security Research projects

that by 2025, 29% of the Japanese population will be 65 or older, and that portion is expected to be 36% by 2050. Can Japan change before it is too late? How will it pay for the welfare state policies that will be necessary? And what kind of policies will motivate young women to choose careers and family, and thus reverse the falling fertility rate?

In two recent books by specialists of Japanese politics, the authors take vastly different approaches, but neither is sanguine about Japan's current challenges. Mr. Kasza's is highly comparative and presents a long-term perspective; Mr. Schoppa's focuses on recent dynamics in Japan. Reading them is unsettling, for the urgency is mounting for Japan to get its house in order.

Mr. Kasza's skeptical analysis and clear-headed comparison of Japan's welfare state with its advanced industrialized peers predominantly finds similarities. To the question of whether Japan is unique when it comes to the core programs of pensions and health care, his answer is a resounding "no."

Mr. Kasza rejects the idea that Japan pursued high-speed growth to the neglect of social welfare. The author demonstrates that the Japanese welfare state was neither a "laggard" nor "stingy" through systematic analysis of the timing of the introduction of various policies, data on comparative welfare expenditures, rates of welfare spending as associated with rates of economic growth, and the legislative record of "welfare commitment." Moreover, he carefully compares programmatic features of old-age pensions, health care and employment policies with those of nine other countries. The upshot is that Mr. Kasza finds high levels of similarity among pensions and health coverage. The one deviation is that under certain conditions large Japanese firms can administer a small part of pensions for their employees—not unusual in other

Ms. Milly is associate professor of political science at Virginia Polytechnic Institute and State University and author of *Poverty, Equality, and Growth: The Politics of Economic Need in Postwar Japan* (Harvard University Asia Center, 1999).

The Japanese welfare state has too often been reduced to the features that separate it from its Western peers.

countries but a more systematic and regulated process in Japan.

Employment policy, which encompasses transfer payments to the unemployed and active labor market policies, is a different story. For the former, the image of a stingy Japan seems apt: Japan's benefits to the unemployed seem to cover a smaller portion of the labor force, the qualifying period for benefits is stiff, and the replacement rates of benefits are low. But the picture concerning active labor market policies is more complex and difficult to compare, as the Japanese government's supports to inefficient economic sectors indirectly provide jobs and serve as employment policies, even though they are not normally considered as such.

Where differences exist between the Japanese system and other welfare states, Mr. Kasza stresses the predominance of similarities. He suggests the role of corporate welfare has been overstated. Besides the clear difference in employment policy, he acknowledges that the role of family in caring for the aged is particularly strong, but stresses that culture has "minimal explanatory power" for the core programs of health care and pension policies.

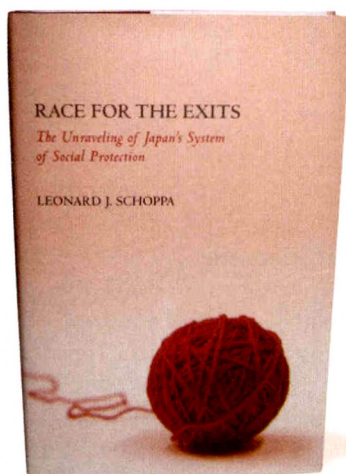
I, too, share Mr. Kasza's view that the Japanese welfare state has too often been reduced to the features that separate it from its Western peers, without adequate recognition of the strong similarities that exist. A serious question to consider for Japan at this juncture, however, is whether the family expectations for women sus-

tained by this system and even the method of employment policies are now obstacles for Japan's choices. While Mr. Kasza would argue, I believe, that these idiosyncrasies will necessarily diminish, Leonard Schoppa's book suggests their legacy continues to obstruct effective policy change.

If Mr. Kasza stresses commonalities between Japan and the rest of the world, Mr. Schoppa focuses on dysfunctional differences. Given the huge public debt, rapid ageing of the population, and falling birth rates, Mr. Schoppa wants to know why there has not been a greater public outcry for reforms in response to socioeconomic changes since 1980. The author answers that some of the groups affected have found alternatives that have muted their motivation to mobilize politically for change. Theoretically ambitious and substantively diverse, this analysis considers the gradual changes in Japan's political economy that account for such behav-

iors as the choice of firms to move production overseas or produce their own electricity, and the choices of women to delay marriage or not have children.

Mr. Schoppa's perspective on the Japanese welfare state emphasizes its interconnectedness to economic production, with more attention to the upper tier of large firms than Mr. Kasza gives. The term "convoy capitalism" becomes shorthand for a broad constellation of policies and practices in the Japanese political economy, from extensive state regulation of firms and financial institutions to the system of



social protection provided through lifetime employment, supports to inefficient industries, and labor market practices that keep women's caregiving role intact. The dominant question here is why the Japanese have not insisted more strongly on change as the system unravels and as the cost of sustaining it grow.

Mr. Schoppa focuses on two groups that have good reason to be frustrated with the system of convoy capitalism: firms and women. Firms were limited by restrictions against laying off workers and paid high prices for goods from protected sectors. Women provided care for the family and gave employers flexibility by occupying mainly part-time and temporary positions. But both groups found options for themselves besides becoming politically vocal, and this delayed government recognition of problems.

Mr. Schoppa maintains that Japanese firms have faced greater difficulty than those in other countries in adjusting to shifts in the global environment since the 1970s because of their role in the system of social protection. Despite a volatile business environment, Japanese firms were expected not to lay off workers, to work with existing supplier networks, "to continue providing extensive employment-related benefits, to find new jobs for redundant employees, and to assist other firms that were part of their network." Firms responded by finding ways to circumvent some of the more onerous constraints imposed by state policies and social convention—moving operations overseas, or changing procurement and production practices to cut costs. Efforts to mobilize for policy change were generally not strong or well-coordinated. This dynamic becomes clear in Mr. Schoppa's exploration of labor market reform, electricity market reform and public sector reform.

For women, the process of change in expectations and opportunities resulted

from a mix of influences, including shifts in the labor market. In the 1980s, as opportunities opened up for women in employment, they began to face the challenge of balancing career with their caregiving roles. Young women often ended up making individual decisions to delay or reject marriage and childbearing, and the effect on the birth rate is clear. But women have not mobilized politically for the changes in government policies or employer practices that might enable them to maintain careers and families.

Mr. Schoppa's book is an in-depth look at the dynamics of the political and economic choices that firms and women have made in response to socioeconomic changes since 1980. While more focused on the problems that the contemporary Japanese state faces than Mr. Kasza's book, it is also more comprehensive in presenting the connections between the government's role in the economy, the explosion of public debt and the choices in social policy the Japanese now confront. As the author indicates, although there has been a breakdown of the previous structure of policies and relationships that supported rapid growth, it is not clear what kind of policy structure is emerging to replace it.

Between them, these books cover a lot of ground. Mr. Kasza uses examples of internationally diffused practices to suggest the key elements of change necessary for Japan, but he is grim about the likely breakdown of its system of social protection and the social peace. He anticipates Japanese would resist the extent of change needed to raise the age of eligibility for pensions, expand child-care opportunities and home help for care of the elderly, or adopt liberal immigration policies. Mr. Schoppa, having emphasized peculiarities of the Japanese system, offers three alternative scenarios Japan could follow. For Japan to avert disaster, he asserts, its "best hope" for a positive transformation

When Japanese citizens pursue political mobilization, their methods may not follow traditional pathways to the top.

is strong political entrepreneurship and leadership, the sooner the better.

Japan now stands in the middle of transition, and the halfway efforts undertaken so far are not enough to resolve the crisis it faces. But consider this: As late as 1959, a government council was projecting massive under- and unemployment as postwar baby boomers reached working age. However this crisis never materialized. We have in Japan a complex system of social and economic changes that are uneven, and the political structure that supported convey capitalism is also in transition. These are changes that are not easily directed by a central state, especially one trying to promote certain types of decentralization.

When Japanese citizens pursue political mobilization, the methods used can be quite innovative and they do not necessarily follow the traditional pathways to the top. One experience that illustrates this is the achievement of Long Term Care Insurance. Long Term Care Insurance is a system adopted to cover those who need long-term care for chronic health problems, and is especially designed for older persons, covering home help, home modifications, etc. Schoppa refers to it as an "exception" that supports his point. This was a major innovation driven by professional women who mobilized and built an alliance with a group of local governments, lobbying all relevant political parties.

This is where I hold out a bit more hope than either author: For some issues since the 1990s, Japanese citizens and local communities *have* stepped in to fill the void of political action. The question is who will provide the leadership to harness this energy, intellect and concern for Japan's future to have an impact in the ways that are needed now.

**THE SHEK KIP MEI MYTH:
SQUATTERS, FIRES AND COLONIAL
RULE IN HONG KONG, 1950-1963**

by Alan Smart
Hong Kong University Press,
227 pages, \$65

Reviewed by FRANCIS MORIARTY

A PAIR OF SEEMINGLY disparate events—the closure of two ageing public housing units and the flare-up of a controversy over Hong Kong's fabled *laissez faire* economic philosophy—has received considerable media attention of late. However the deep historical links between them and the implications for the territory's governance have passed with scant comment.

The multistory buildings being shut are the last portions of the Shek Kip Mei Estate, built after a massive blaze in a dense squatter area that began on the night before Christmas, 1953. By the time it burned out, thousands of shanties were in ashes and tens of thousands of inhabitants homeless. Of the two estate structures remaining, inhabited in recent years mostly by elderly tenants, one is to be razed and the other turned into a housing museum.

Meanwhile, the debate on economic philosophy—not usual tinder for sparking controversy in staunchly capitalist Hong Kong—has seen two Nobel Laureates in economics weigh in to express worry that the administration of Chief Executive Donald Tsang was abandoning the traditional policy of "positive non-intervention" and getting the government increasingly enmeshed into the workings of

~ Mr. Moriarty is senior political reporter at Radio Television Hong Kong.

the markets. So sensitive is this topic that Tsang has been drawn ever-deeper into the debate, which he himself opened by saying that the current philosophy of the government was "small government, big markets," but that the government would intervene with corrective action whenever market mechanisms were failing.

It is this nexus of housing, population policy, politics (including geopolitics) and "non-interventionist" governance that is at the center of Alan Smart's insightful and highly readable deconstruction of the Shek Kip Mei "myth."

Mr. Smart, a professor of anthropology at the University of Calgary, is well qualified for the task of analyzing and re-evaluating the role of Shek Kip Mei in the formation of Hong Kong's sense of collective identity, and its effect upon governance. He is the author of a previous book on squatter clearance in Hong Kong and, along with his wife and then-newborn daughter, is among the very few foreigners ever to have lived in a squatter settlement. This experience included having their own residence burn down in a fire that killed their host's mother.

There is no area of economic or social life where the ostensibly hands-off Hong Kong government has been more deeply hands-on than in the provision of land and the production of housing. The former involvement began immediately after British colonialists asserted control over Hong Kong and declared that all land belonged to the Crown, thereby assuring that subsequent governments would rely on land sales as a principal revenue source and laying the basis for the colony's vaunted "low tax" regime.

The establishment of "Crown Land" has also meant that the government benefits from high property prices and has a strong incentive in maintaining a non-interventionist policy, or the fig-leaf of one, when it comes to property development.

Land premiums in the current year are expected to fetch the government more than HK\$30 billion (\$3.86 billion).

The government's involvement in the provision of housing has no similar historical antecedent. For the first century or so of British rule, colonial overseers had little interest in how the Chinese inhabitants housed themselves, beyond concerns revolving around crime, hygiene, moral corruption of soldiers and, increasingly in the post-war era, political agitation.

The Shek Kip Mei blaze in 1953 is credited, in official accounts and prevailing urban myth, with precipitating the decision by a deeply reluctant British colonial government to embark upon what would grow, eventually, into one of the most ambitious public housing schemes anywhere. The fire is popularly viewed as a critical turning-point, a terrible event that inspired the government to make a radical decision: to turn its energies and resources toward providing the first of the multi-story dwellings that would climb skyward over ensuing decades, transforming Hong Kong into the vertical cityscape we see today, a city in which half the population lives either in public rental housing or in flats acquired through government-sponsored ownership schemes.

Implicit in this happy-ending interpretation is a sense of underlying governmental beneficence. It is this perception—or, misperception—at which Mr. Smart takes careful aim.

Does the grand public housing development stand as testimony to a policy success? Or is it a monument to the colonial bureaucrats' recognition that every other viable option had already been tried and failed? Did the market fail these squatters? Or had government policies and practices themselves inhibited any market response that might have addressed the problem earlier?

Official histories, including Hong Kong

The ostensibly hands-off Hong Kong government has been deeply hands-on in the areas of land and housing provision.

Housing Authority exhibits, invariably mark the start of the public housing saga with the Shek Kip Mei fire. This harmonizes with the common perception, developed over the past half-century, of Hong Kong as a small territory inundated after World War II by immigrants fleeing the civil war between Communist and Kuomintang armies—a rivalry in Hong Kong that complicated the government's actions.

According to this historical construction, the colonial government was indifferent and perhaps clay-footed, but along with most people at the time it was seeking to cope with unanticipated problems on a massive scale, busily struggling to make the best of a bad situation. The can-do spirit and sense of togetherness during this era forged the collective identity of Hong Kong people. When viewed in this nostalgic context, the Shek Kip Mei fire is popularly re-interpreted as a tragic wake-up call, a one-off catastrophe on a magnitude that aroused an otherwise occupied British administration into action.

As Mr. Smart reveals through diligent combing of the colonial records, the reality of the time was significantly different than the subsequent myth.

The squatter areas were often highly developed, containing stone buildings amid the shanties. While many squatters built their shelters, others rented them from squatter landlords who, in some cases, might be described as squatter developers. Tellingly, census data show that the origin of the squatters closely resembled the demographics found in the rest of Hong Kong.

The government was in a quandary: It did not want to encourage squatting, although it had tolerated squatter areas, and was fearful of any move that could be seen

as legalizing the squatters' condition. For this reason, among others, steps that could have reduced the possibility of fire, or improved the response of fire services, were not taken.

More to the point, the official policy—hardly benign—was to allow conditions in the squatter areas to deteriorate to the point where residents would return to the mainland rather than endure the hardship.

The fire at Shek Kip Mei was an inevitability, with small businesses and cottage factories jammed alongside wooden shacks with open cooking. But it was not the first such blaze, nor the last. It was a very large fire, but not the only large one. No less important—and perhaps more important in the public housing story—were the fires at places like Tung Tau and Tsuen Wan (or Tsun Wan, at the time). Nevertheless, Shek Kip Mei stands in popular imagination as a turning point.

What Mr. Smart lays out in documents culled from government records is a contrarian view: In fact, even before the Shek Kip Mei fire, the government was already being dragged into the recognition that no solution was possible without mass rehousing and concentration of the squatters into smaller, more dense developments now made possible by architectural innovations allowing for multistory buildings. Government land formation was also faster than work done by the squatters themselves. And condensing the squatters into smaller places would curtail their steady encroachment into urban areas, with all of the hygiene, security, stability and land-use problems that would entail. This fit with a developing view of the kind of city the administration wished Hong Kong to become.

Running through the story is the government's preoccupation with China's re-

action and with the mainland's ability to create social unrest in the colony through its United Front activities. There is much in Mr. Smart's critical re-evaluation of the Shek Kip Mei myth that is of use in understanding the roots of governance issues still facing Hong Kong today.

**THE WRITING ON THE WALL:
WHY WE MUST EMBRACE CHINA AS
A PARTNER OR FACE IT AS AN ENEMY**
by Will Hutton
Free Press, 432 pages, \$28

Reviewed by HUGO RESTALL

THE APOCALYPTIC TITLE of this book, as well as the fact that Will Hutton is a former economics editor of Britain's left-wing Guardian newspaper and a governor of the equally notorious London School of Economics, might lead one to suspect it is yet another screed about the perils of globalization. Yet it turns out to be a reasonably good argument for why the U.S. and Europe should keep their markets open to China, while Chinese should learn from the political institutions of the West.

The emphasis is on the word "should." Mr. Hutton, a longtime columnist, has penned an extended editorial, which in parts degenerates into a history lesson, and then a rant against the Bush administration. Nevertheless, where he concentrates on China's economic rise it is an impressive summation.

Those who care about China's future should be thankful that a thinker from the social democratic end of the political spectrum is espousing responsible views. As control of the U.S. Congress passes into the hands of the Democrats, the danger is that

protectionist murmurings will increasingly find their way into legislation. Directed primarily at Americans, the book makes a solid case that the U.S. is benefiting tremendously from China's economic recovery.

Mr. Hutton looks back fondly to the New Deal era, when President Franklin Roosevelt blamed the Great Depression in part on protectionism. Then Secretary of State Cordell Hull embarked on a program of negotiating tariff-lowering agreements with other countries, the principles of which still underpin the World Trade Organization. Yet for all the Democratic Party's free trade roots, its representatives have fallen under the thrall of economic populism and turned against initiatives like the Central American Free Trade Agreement.

For this reason alone, it would be no bad thing if Democratic congressmen all got a copy of this book. Perhaps it's with this market in mind that Mr. Hutton reserved his harshest criticism for American conservatives and the Bush administration, which have after all held the line against congressional calls to retaliate against China.

To do so, he engages in some rhetorical fancy footwork. He posits that in order to succeed in the global economy, a society needs a combination of liberty and "enlightenment values." So far, so good. China has increased economic freedom, but it lacks the institutions of the "public realm" that impose accountability on the powerful, such as the rule of law and political pluralism. That is why it fell behind Europe in the 19th century, and will falter again if political reform is not addressed. It's not a bad thesis.

But Mr. Hutton goes off the deep end when he claims that the U.S. suffers from the same problem. He laments the ascendancy of the right in American politics with its emphasis on economic freedom, despite the evidence that this has revitalized the economy and society as a whole, as it did in Britain. Instead he believes that

∞ Mr. Restall is editor of the REVIEW.

Those who care about China should be thankful a social democratic thinker is espousing responsible views.

"the United States has become a more immobile, sclerotic society." He doesn't address the possibility that more economic freedom is needed, concentrating on the supposed damage done to the "Enlightenment tradition" by "a socially conservative movement centered on cultural propositions concerning the family, abortion, the desirability of prayers in school, religion, and resistance to the sexual revolution."

So if the U.S. funds stem-cell research, it can compete with China? Mr. Hutton seems aware that this will be viewed by many with incredulity: "No doubt, some conservatives reading these pages will think that the criticism of American democracy as retreating from its Enlightenment legacy is little more than liberal sour grapes." Yes.

One reason is that we discover Mr. Hutton disdains the very institutions that have increased accountability in American public life, such as private ownership of pension funds in the form of 401(k)s, as opposed to corporate defined-benefit plans. He thinks that the trend toward corporate takeovers and leveraged buy-outs has led to "short-termism" in management, instead of recognizing that these phenomena have held managers' feet to the fire and forced them to concentrate on shareholder value.

In fact, with the exception of free trade, Mr. Hutton signs on wholesale to the economic and social rhetoric of the left. He cites as shameful the fact that millions of

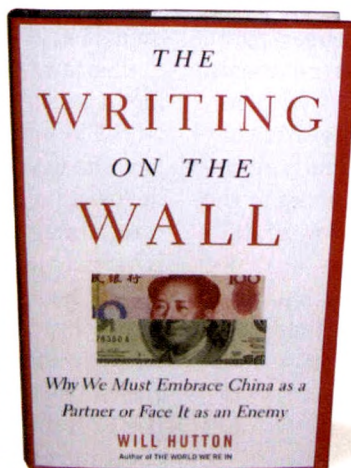
American workers earn a minimum wage that for a head of household would put them below the poverty line, but fails to note that most such workers are teenagers in their first job or else quickly move up the wage ladder. He claims to be disappointed by the lack of diversity in the perspectives

offered by American media, by which he means the success of right-wing talk radio hosts and the Fox News network. This is a strange idea since, whether one agrees with them or not, these forces have increased diversity in a media arena that had been overwhelmingly dominated by the left.

On one point regarding the American media Mr. Hutton is correct—both sides of the globalization debate are distorting the magnitude of the phenomenon:

I am on the same side of this argument as [Thomas] Friedman, but I think the entire exchange should be cooled down. The impact of globalization is vastly exaggerated by him as much as by [Lou] Dobbs and [Ernest] Hollings.... It is alarmist, counterproductive, and intellectually wrong to associate the ills of western industrialized societies with globalization and with foreigners.

But what is the root cause of these ills? Considering that Mr. Hutton has done better at diagnosing the problems of China than the societies he has lived in, perhaps we should ask a Chinese columnist to address this question. ■



CHINA'S ANIMALS GET NEW RESPECT

by Jeremy Hurewitz

THE LIYUAN DOG market is located on a windswept lot in the Tongzhou district of Beijing. Most vendors are selling what appear to be pure-bred dogs, clearly as pets, not meals. Requests for dog meat are met with embarrassed smiles and protests that they don't do that anymore. But finally someone quietly points towards an area at the back of the lot, where another row of stalls stands.

There Liu Huazhu beams with pride as he describes his dog business. When asked about dog meat, he points to a cage housing two mangy-looking large dogs. His business card offers a full range of "dogs and dog meat."

Mr. Liu used to be able to butcher the dogs here and sell the meat directly to people who would take it to some of the restaurants that lined the market and specialized in cooking dog. He complains that negative press reports caused officials to crack down, closing the restaurants and restricting him from killing dogs in the market. A smaller (tastier) dog goes for 20 yuan per kilo, or around 400 yuan for a whole dog. One of the larger dogs in the cage, which weighs around 40 kilos, would cost 500 yuan.

These days Mr. Liu is often the only one at the market offering dog meat, though in the winter business is better because the Chinese believe that eating dog meat keeps you warm. He has been in the dog business since 1995.

The timing is significant, because that was the year Beijing City enacted a law requiring dog owners to register their pets and pay a fee of 5,000 yuan (\$604), a charge that many couldn't afford. Suddenly the supply of cheap dogs surged as owners abandoned their pets en masse.

The law changed the life of Zhang Yuping in an entirely different way. Disturbed by the animal emergency she saw around her, she quit her career in real estate and devoted herself full-time to animal welfare. Today she runs a shelter in the outlying Changping district.

The facility is built like a fortress, with high gray walls surrounding its 21,000 square meters. Most of the funding comes from abroad, from the Royal Society for the Prevention of Cruelty to Animals and the International Fund for Animal Welfare. As well as a veterinary clinic, classroom and quarantine area, the shelter houses 12 dog and cat kennels with more than 400 animals, which seem in generally good shape.

Ms. Zhang describes her effort to lobby the government to change the registration law, which was eventually successful and led the government to reduce the fee to 1,000 yuan from 5,000 yuan, and half that if the dog is neutered or spayed. As she speaks she strokes a tiny kitten that has climbed up on the table. Ms. Zhang sips from a metal thermos of tea-leaves and communicates warmth from her eyes, a light blue eyeliner the only nod to feminine vanity in a woman consumed with more important things.

Ms. Zhang has been using the good government contacts she built up as a businesswoman and activist over the past

~ Mr. Hurewitz is a Shanghai-based writer.

several decades to push for a nationwide animal-rights law. "My hope is that the Chinese government will look overseas for a model, and that with the government focused on its international image a law will be passed before the 2008 Olympic Games," she says.

China is not known for its enlightened views toward animals. In a country where human rights is still a term that can get you into trouble, the concept of animal rights seems strange to most people. Aside from wildlife regulations protecting some endangered species, there is currently no law that protects animals. But there is a rising movement—both Chinese and foreign—pushing the government to pass such legislation. In November, when the Beijing authorities started a new crackdown on unregistered dogs, owners staged public demonstrations, a rare event in the tightly controlled capital.

The humane societies that have been popping up in Chinese cities during the last decade or so are largely small groups trying to find homes for abandoned cats and dogs. These groups generally have Web sites and try to educate Chinese about sterilization and how to care for their pets. They often publicize acts of cruelty and shame the perpetrators.

Beijing's Pet sos was founded by Tian Yuan and her husband out of a fondness for animals (even though Ms. Tian is allergic to most of them). She says they are circulating a petition pushing for an animal-rights law and hope to deliver it to a representative from the National People's Congress in the near future.

The animal-rights movement is driven by China's extraordinary economic growth. Upwardly mobile Chinese increasingly are adopting pets into their lives. The one-child policy has encouraged parents to fill out what were traditionally large families with animals.

But Dr. James Holder, a veterinarian

from the U.K. who has been practicing in China for the last four years, sees a population little prepared to care for their pets. He feels that while the rising demand for pets has undoubtedly been good for the overall cause of animal welfare, "there are over 100 million pets in China, too many in a country that doesn't know how to care for pets."

Seeing them as a surrogate for the children, "they treat dogs like babies, allowing them to eat from their table, and they never discipline them," which leads to unruly behavior. Pets are fattened up, just like children. But overweight animals tend to have health problems, and health problems lead to medical costs. Unruly and sick dogs are often abandoned.

To understand the unique nature of China's relationship with animals one must visit Guangdong province. The southern region bordering Hong Kong and Macau is the source both of China's strangest culinary tastes and the incubator of frightening new diseases. The locals brag that they eat "anything with four legs except a table, and anything that flies except a plane," in part because they believe that eating wild animals promotes vitality. A favorite dish in these parts is "Dragon-Tiger-Phoenix Soup," made with snake, cat and chicken.

But such tastes have led to public health crises. SARS is said to have originated in this area from civet cats that were sold in the wildlife markets. It is difficult to pin down exactly where bird flu developed, but many feel that this area is uniquely capable of producing zoonotic diseases that jump from beast to man. Virologists believe that avian flu viruses started crossing the species barrier after the domestication of fowl in southern China around 3,000 years ago, and point to flu epidemics in 1957 and 1968 that originated in this area.

But it is clear that the post-SARS environment of southern China, coupled with the ongoing concerns over the H5N1 flu,



Security forces kill an unregistered dog in a village outside of Beijing as part of a vigorous campaign to enforce stringent dog-ownership laws China recently implemented in response to its rabies problem.

has changed the open nature of the infamous wildlife markets. The SARS outbreak originated out of Guangzhou's Chou Tou market or a market just like it that sold palm civets, which are believed to be the original reservoir of the coronavirus. Chou Tou is still open, but the government has restricted the sale of wild animals. The cramped, corroded cages that housed a huge variety of fauna are conspicuously empty. The vendors say that they can no longer keep the animals in the market, but they can get whatever a customer wants.

Professor Mang Ping of the Central Socialist Academy in Beijing is perhaps China's best-known animal-rights activist. Her advocacy began in the 1980s when she was disturbed by changes she was witnessing. As the economy boomed, the country moved ever further out of harmony with the natural world. She noted a growing environmental wasteland and disturbing culinary trends spreading from Guangdong province. Many of the Special Economic Zones were established in this southern province and their success led local habits to become fashionable in other areas of China, one of which was the eating of exotic wildlife.

Professor Mang began writing articles urging Chinese to show greater respect toward animals. She criticized conditions in Chinese zoos and the tendency of people to throw rocks at the animals. She got a

positive but flabbergasted response—one woman called her up and said, "I could never have imagined someone writing an article defending the rights of animals before reading yours."

But what really distinguishes Professor Mang is her deep understanding of Chinese history and her finger on the pulse of trends within society. She has focused on "trying to remind the Chinese of their traditions of mercy" by writing books about the beliefs of Confucius, who successfully lobbied to have the hunting season reduced to give animals the chance to regenerate, and about the traditions of Taoism and Buddhism, both of which preach respect for nature and all living creatures and have strong associations with vegetarianism.

Professor Mang sees a social sickness within China that manifests itself in cruelty to animals. She looks around China and sees a country retarded by the war, famine and crazy social experiments of the 20th century, all of which have now been exacerbated by breakneck economic growth leading to rampant corruption and selfishness.

What stands out the most for Professor Mang among these periods—perhaps because she lived through it—is the Cultural Revolution. On top of all the hardships already suffered by the Chinese, "the Cultural Revolution finally made people lose their mercy." She shakes her head and talks about "cats thrown out of windows" because "pets were considered part of the capitalist lifestyle." When Professor Mang hears people tell her that human problems are more important than anything related to animals, she replies that attitudes toward animals are a bellwether of society's health.

But Professor Mang—a petite woman, casually dressed in a white zipper sweater, with short black hair—is practical and says the government is most ready to act when it comes to combating disease, so it

Professor Mang Ping sees a social sickness within China that manifests itself in cruelty to animals.

is more receptive to ideas about raising hygiene standards for animals on farms than dealing with a more general law banning outright cruelty to animals. But the government worries about enforcing any sort of animal welfare law. Raising hygiene standards or creating rules for farming practices to reduce the suffering of animals might encounter resistance in the provinces, where it will probably bring higher costs, and the government is already nervous about rural unrest. It would embarrass the government if it enacted a law that was ignored.

There is a tradition within Chinese culture of dealing with social deviance outside the context of the law. For instance, in March this year a video circulated on the Internet of a Chinese woman in a black miniskirt and stiletto heels caressing a kitten on a road near Hangzhou. She then placed the kitten down and stepped on it, brutally killing the little creature with a casual smile on her face. The sequence was among a number of similar videos on a fetishist Web site that specialized in showing pretty women crushing small animals.

The media picked it up and China's busy chat rooms exploded with indignation. Eventually the netizens tracked down the kitten crusher, Wang Jue, a nurse at a hospital in Luobei County, Heilongjiang province. When her bosses found out what happened they suspended her. Li Yuejun, who sold the video for 15 yuan per CD, was a cameraman at a local TV station and he was also suspended.

Professor Mang says she is encouraged by the fact these actions caused opprobrium and negative consequences for the perpetrators. "Attitudes towards animals are

changing step by step." But for real change in China "we need an animal protection law modeled on those from abroad."

One organization that is actively changing attitudes is Animals Asia. Founded by Jill Robinson in 1998, the group is best known for its efforts to save Moon Bears from the practice of farming them for their bile, which is an ingredient of traditional Chinese medicine. In July 2000, Animals Asia signed the first agreement between the Chinese government and any outside animal welfare organization, pledging to rescue 500 bears from the worst farms in Sichuan province and work towards the final elimination of bear farming.

Their other priority is a "Dr. Dog" program, operating in Hong Kong, Guangzhou and recently in Chengdu, with the slogan "Friend Not Food." The organization takes dogs specially selected for their tolerant and friendly personalities to visit hospitals and schools, cheering up the sick and educating children in an effort to show that dogs are better suited as companions than as food.

Executive Director Annie Mather says that the organization's "overall objective is to improve animal welfare in China." They see the China Bear Rescue and Dr. Dog programs "as two poles of animal welfare" which introduce "the concept that animals have complex feelings." These two poles easily appeal to intrinsic human emotions and help to gently pose greater questions about how society views animals overall. Only then will the abuse of animals become unacceptable. "It will end from within," says Ms. Mather, "not because of the international community stamping their feet." ■

Budget Skirmish

THE WASHINGTON TIMES-INSTIGATED contretemps over a Chinese Song-class submarine getting within five miles of the aircraft carrier USS Kitty Hawk is hard to fathom. OK, so the Chinese captain of the sub did well in getting that close without being detected—if in fact that is what happened. But monitoring another navy's exercises is hardly a sign of “stalking.”

The real story here is that the U.S. Navy has happened upon an opportunity to talk up China's naval ambitions in order to bolster its own lobbying effort for increased spending on expensive ships and weapons systems.

Are we really to believe that in the event of hostilities, a U.S. carrier battle group would have much to fear from the notoriously noisy Song-class submarine, with its unreliable antiship missiles and slow torpedoes? The incident may have also been leaked by those within the Pentagon who don't want increased military-to-military contacts with the Chinese, especially since it took place when Admiral Gary Roughead was in Beijing.

China's Philosophy of IPR

THOSE WONDERING WHETHER the Chinese value system includes respect for intellectual property rights should pay a visit to the Web site of People's University's philosophy department. Not for the content, however. Rather the design and the orange and black color scheme struck us as rather familiar, where had we seen it before, could it be ... the Princeton University home page!

As the Chinese saying goes, to steal a book is an honorable offense, and the philosophers seem to be sending the same message about stealing Web pages.

Elite Girl

THE SINGAPOREAN ONLINE community's outpouring of hatred against Wee Shu Min—a daughter of a Peoples Action Party member of parliament and student at the country's top high school who had the temerity to tell the truth that those who haven't succeeded in Singapore are “wretched, undermotivated, overassuming leeches in our country” who should “get out of my elite uncaring face”—has really gone too far.

Witness this series of cartoons entitled *Elite Girl* (see <http://www.insanepoly.com/blog/>). Rarely have we seen such verbal cruelty to another person based on their station in life.

Beijing's One Dog Policy

SO NOW BEIJING residents can have just one child and one dog, according to a new regulation designed to curb the canine population. Pretty soon it will be one cat, one gerbil, one cricket.... a Malthusian fanatic's version of Noah's ark, in which all species are split off into ones in order to frustrate their drive to go forth and propagate.

The irony is that because the one-child policy was implemented at a time when dissent was impossible and now people have grown accustomed to it, the weeping and lamentation over being limited to one canine companion is going to be many times more pitiful than the protests at state-coerced abortions and sterilizations. Is there anything stranger than human nature?

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keys to a successful IP transformation.

by  **verizon**business

WHY UPGRADE?

If your Frame Relay or ATM systems are aging and the cost of maintaining your current network equipment is growing, it may be time to upgrade to IP. Not just for the advanced capabilities IP provides but for the efficiencies gained from a more streamlined network. You could realise those efficiencies quicker than you think, so if you're ready for IP, it doesn't pay to wait.

TAKE IT ONE IP AT A TIME.

Many companies have implemented one or more enterprise IP applications, such as automated billing or expense systems, customised to their unique needs. They are now advancing to applications like VoIP that can quickly expand interoffice and customer-relations capabilities. The provider you choose should offer a wide range of IP applications, the flexibility to customise them to your business needs, and the expertise to support them all at any scale.

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MPLS-based Private IP offers two key advantages: it simplifies your network topology by providing any-to-any connectivity and it delivers multiple classes of service, so you can prioritise voice, video, and data traffic over a single network.

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Make sure your provider's capabilities extend as far as your business goals: is their IP technology deployed globally? Are their IP solutions scalable? Do they have wholly owned points of presence in every country where you have an office or mobile employee? And are you satisfied with their record of security, availability, and reliability?

PLAN, ORCHESTRATE, MANAGE.

Your transition to IP is an ongoing process, not a project with an end-date. So the experts you choose to facilitate it should be with you from the beginning and stay with you as your needs evolve.

Look for a complete partner, one that will commit to strategising, designing, implementing, managing, and optimising your IP technology. In other words, work with a company that backs up its capabilities with accountability.

TALK TO THE IP LEADER.

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